CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
AGRICULTURAL LAND REAL ESTATE PROGRAM

November 13, 2000

This Policy is effective immediately upon adoption and supersedes all previous agricultural land real estate policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Agricultural Land Real Estate Investment Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Program.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return possible consistent with a prudent level of risk, the liabilities of the System, and the investment guidelines contained herein is the strategic objective of this investment program. The System shall consider its agricultural land investments as a component of the specialized equity real estate portfolio. Therefore, such investments shall be required to achieve an appropriate risk-adjusted return.

All investments in agricultural land are subject to the investment processes described in the Statement of Objectives and Policies for the Equity Real Estate Portfolio, as well as the Delegations of Authority, both incorporated by reference hereto.

The Agricultural Land Real Estate Portfolio ("the Portfolio") shall be managed to accomplish the following:

A. Preserve investment capital;

B. Generate attractive risk-adjusted rates of return for the System as a total return investor, including the following components:

1. Provide, at a minimum, moderate to low cash flow from operations; and

2. Provide appreciation potential resulting from biological growth and active management techniques including, but not limited to, agricultural best practices;

C. Provide a hedge against inflation; and

D. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVES

The Portfolio shall be managed to assist the System in achieving its overall long-term objectives as follows:

A. Exceed, after fees, a minimum target real rate of return of 6.5%; and

B. Exceed, before fees, the National Council of Real Estate Investment Fiduciaries Farmland Index ("NCREIF Farmland Index") while maintaining a prudent level of risk.

IV. INVESTMENT APPROACHES AND PARAMETERS

A. Risks

Compared to other real estate investments, agricultural land has several unique risks associated with it. Such risks include, but are not limited to, the following:

1. Government farm and trade policies' influence on investment economies;

2. Demand impact on commodity prices;

3. Currency fluctuations' impact on sensitive exports;

4. Weather and other natural elements' (e.g., unusual precipitation, damaging insects, and flooding) effects on crop yield and value;

5. Costs associated with long-term environmental and food safety issues;

6. Dependency on regional and local water supplies, as applicable;

7. Labor supply and demand factors related to agricultural operations;

8. Specialized nature of professional management; and

9. Stakeholder and consumer responses to industry practices (e.g., pesticide impacts on products, neighboring properties, and farm workers).

The potential for diversification among regions, investment characteristics, and commodity/product types mitigates some of these risks. The use of well-qualified farm managers familiar with the particular commodity and region also can minimize exposure to manageable risks. Furthermore, the advantages of investing in agricultural land include returns that have historically provided an inflation hedge and are negatively correlated with other property types.

B. Diversification

The Portfolio should be well diversified to minimize risks due to overexposure to any one risk factor. Market opportunities and conditions, rather than absolute and precise diversification targets, shall be the overriding factors in constructing the Portfolio. The Portfolio shall be diversified along the following criteria:

1. Asset Mix: Diversification between row crops (commodities such as e.g., corn that must be replanted after harvesting) and permanent crops (commodities such as, citrus fruits that do not need to be replanted on a periodic basis);

2. Geographic Region (representation in major agricultural regions);

3. Micro-diversification (diversification among micro-climate zones within geographic regions); and

4. Crop Type and Mix (diversification among crops with favorable outlooks and complementary risk/reward profiles, such as, organic vegetables).

C. Size

Agricultural land investment size at the transaction level depends on the opportunities available to the System, with neither small nor large investments dominating the Portfolio. Location, acreage, and price per acre of land purchased are factors determining the size and price of a transaction.

Investment size shall be appropriate to the projected risk/return level of the Portfolio. Large transactions may provide economies of scale in operations and pricing, but at the risk of less liquidity. Conversely, smaller transactions may be more liquid, but may not provide economies of scale in pricing, operations or both, as would those of larger transactions. The appropriate investment size shall also be a function of the Portfolio's target geographical and crop diversification.

D. Structure

Leveraged equity, equity, mortgages, entity-level, and hybrid investment structures are available to the System. The System shall adopt maximums for each type of investment structure prior to investment.

E. Vehicles

The System shall invest in agricultural land on a direct or indirect basis. Should a commingled fund be chosen, the System generally will not commit to investing more than 25% of the target size of any one commingled fund for the diversification provided by having multiple investors in commingled funds.

F. Selection of Management Firms

The System shall select third-party investment advisors, general partners, operating company management teams, or other organizations (collectively referred to as "Management Firms") with specific expertise in agricultural land real estate investments to advise on or co-invest in its agricultural land investments.

1. Management Firms shall provide expertise and experience in locating, negotiating, monitoring, and disposing of agricultural land investments. The System shall establish and document specific relevant criteria for each Management Firm prior to selection to establish the basis on which the selection shall be made.

2. The System shall approve Management Firms based on their successful history or significant potential in managing and implementing agricultural land real estate investment programs, and their reputation.

3. Due to the non-traditional, highly specialized nature of agricultural investment, Management Firms selected shall have investment and asset management discretion as delegated by the System in accordance with the contract, with oversight and periodic review by the System.

4. Management Firms will represent only the interests of the System in these transactions, or only the interests of the investor group if

the System co-invests with another client or other clients of the advisors.

G. Investment Criteria

Generally, the System's agricultural investments shall include the following:

1. Land in parcels large enough to achieve operating efficiencies, yet small enough to maintain strong resale potential;

2. Land serviced by readily available water from either local sources or an efficient and secure regional/state water distribution system;

3. Land located in areas characterized by clement climatic conditions conducive to high yield levels;

4. Land demonstrating a consistent and favorable yield history;

5. Land with fertile soil requiring maintenance and enhancement within the cost range of industry norms; and

6. Land located close to market or distribution centers in order to reduce costs.

The System may make exceptions to the criteria listed above upon completion of appropriate due diligence and documented demonstration of the investment efficacy of doing so.

H. Asset Management

Management Firms shall act in a fiduciary capacity and represent the System's interests in asset management decisions, providing daily property management services, as expertise and organizational structure allow. The System shall delegate appropriate authority to Management Firms while requiring that they provide adequate measures of accountability.

The System shall strive for consistency of financial and operational controls and reporting requirements, between the System's timberland and agricultural land investments. As appropriate, the System may allow some minor modifications to reflect the specific asset management requirements of agricultural land investment.

V. GENERAL

A. The System considers agricultural land a "specialized" investment as it offers the opportunity for the System to earn higher risk-adjusted returns than the Core Portfolio. Agricultural Land Investment also minimizes overall portfolio risk due to its ability to diversify the Equity Real Estate Portfolio.

More specifically, investment in agricultural land provides additional diversification to the System's portfolio, as its returns are negatively correlated with other property types. The structure of investment and long-term real rate of return shall be related to the relative risk of the investment due to geographic location, crop type, crop mix, and relative control over the investment.

B. This Policy contains a Glossary of Terms in Section VIII. of this document.

VI. VALUATION

Unless otherwise noted, investors, managers, consultants, or other participants selected by the System shall base all calculations and computations on fair-market value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation. Where there are differences between USPAP and agricultural industry best practices in appraising agricultural land, the standards of the agricultural industry shall be followed.

VII. ASSET ALLOCATION

As a percent of the total allocated Specialized Real Estate Portfolio, Agricultural Land, in aggregate with other Alternative Strategies,[1] as further defined in the Specialized Policy, shall range from 0 to 30%.

From time to time, the actual investment may fall out of the allocation range~~s~~ prescribed by the Policy. In these instances, adjustments to correct the actual to comply with the Policy shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period). When making such adjustments, investors, managers, consultants, or other participants selected by the System shall give ample consideration to preserving the investment returns of the System.

VIII. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

[1] Alternative Strategies also include opportunistic investment, hotels, franchise finance, and mezzanine debt investment programs.

NCREIF Farmland Index – National Council of Real Estate Investment Fiduciaries Farmland Index; may be used as a benchmark for performance objectives.

USPAP – Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation; may be referenced for a standard definition of “market value” or “fair market value” for accounting purposes.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
CALIFORNIA URBAN REAL ESTATE

April 14, 2003

This Policy is effective immediately upon adoption and supersedes all previous community housing and development policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the California Urban Real Estate (CURE) Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the execution of real estate investment strategies.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return for the System is the strategic objective of the Program. The System considers California urban real estate investments a component of the Specialized (or "Non Core") Equity Real Estate portfolio, and as such, they shall be required to achieve an appropriate risk-adjusted return.

CURE investments include, but are not limited to low-to-moderate-income housing, multi-family low-income housing, commercial or residential or both, urban infill, community redevelopment, and rehabilitation of core properties. The System shall make such investments under specified conditions and circumstances as described in this Policy. The structure of investment and long-term rate of return shall relate to the relative risk of the investment due to the type, nature of, and relative control over the investment. Minimum acceptable returns shall stay consistent with those defined by the Statement of Objectives and Policies for the Equity Real Estate Portfolio. Returns shall remain acceptable unless the level of risk, as a result of guarantees or subsidies, is below the level associated with other real estate investments made by the System.

III. INVESTMENT APPROACH AND PARAMETERS

A. Approach

Investment in the Program does not imply reduced expectations for returns or increased willingness to accept risk. The System shall only invest in situations where the investment risk is no greater than in other real estate investments made by the System. If the risk inherent in a particular project is unacceptably high, then the System shall require guarantees, subsidies, or other financial assistance by government agencies to reduce risk to an acceptable level.

The System shall ensure investments meet the following criteria:

1. Meet standard of prudence required of other investments, and thus affirmatively meet the prudence and “sole-interest” standard.

2. Any benefit the investment may confer on other interests is not the responsibility or within the ability or control of the System, but only of those who manage or are otherwise responsible for the target enterprise.

B. Asset Selection Criteria

The primary emphasis of the Program is in the State of California. The primary types of CURE projects covered by this Policy are outlined in the succeeding paragraph.

1. Residential, office, retail, entertainment, hotel, and mixed-use projects shall be considered. Asset selection shall be based upon traditional real estate measurements for long-term sustainability.

   The System shall consider projects and development sites characterized by the following key elements:

   a. Sufficient size to create a mix of uses and critical mass;

   b. Single ownership and control;

   c. Compatible surrounding land uses and densities;

   d. Environmentally clean or manageable remediation; and

e. Access to public and private transportation routes, housing, retail services, and amenities.

2. Other projects that may not be specifically defined below, but that benefit certain economic groups or geographic areas and meet the risk/return objectives of the System, may also be considered. This Policy addresses investments in both existing and development projects. While age-restricted housing projects are not prohibited by this Policy, they are intended to be governed by a separate policy (Statement of Objectives and Policy for Senior Housing Investments).

a. Low-income Housing - Rental or for-sale housing projects with a portion of the units targeted for low-income or very-low income residents. (Low-income is defined as 80% of median income; very-low income is defined as 50% of the median income.)

This category may include acquisition financing for public agencies seeking to purchase "at risk" rental projects where affordability is endangered by expiring rent restrictions. The System may consider investing in for-sale projects with restricted affordability up to 120% of median income level when sponsored by a public agency attempting to promote home ownership. The System shall require financial sponsorship or other assistance by the appropriate governing public agency prior to investment.

b. Multi-family Low-income Housing - Small group-care housing or shelters for disadvantaged groups. Additionally, this type of housing encompasses community development loan programs sponsored and subsidized by public or private entities offering low-interest loans and attractive terms to residents within a specific geographic area for neighborhood revitalization.

c. Economic Development or Redevelopment - Commercial, industrial, mixed-use, residential development or revitalization projects that may or may not leverage public resources. Their design directly benefits businesses, employees, or residents of low-to-moderate-income areas, or underserved markets.

d. Urban Infill and "Smart Growth" Strategy - The acquisition, development, redevelopment, repositioning, conversion, and eventual disposition of office, retail, residential, hotel, and mixed-use projects. Smart Growth encompasses assorted initiatives addressing the increasing concern of communities about suburban sprawl and its impact on communities, open space, air quality, traffic congestion, and existing infrastructure. Many of these communities are redirecting development and infrastructure investment within the existing core. The System shall seek profitable investment opportunities consistent with these trends. Such opportunities may include investment in traditional urban cores, urban infill, and suburban infill.

C. Investment Vehicles and Structures

The System shall invest in CURE projects through equity structures and investment vehicles as allowed under the appropriate sector or other appropriate Policies (e.g., Core Apartment, Retail, Office, Industrial, or Single-Family Housing Program). Similar vehicles, consistent with the System's Hybrid Debt and Joint Venture policies, may also be acceptable. The above-mentioned Policies outline the acceptable criteria for the investment structure and vehicles.

1. For existing projects, the preferable structures include, but are not limited to, the following:

   a. Commingled funds

   b. Direct equity investments

   c. Direct mortgages

2. For development projects, the preferable structures include, but are not limited to, the following:

   a. Commingled funds

   b. Direct equity investments

c. Equity joint ventures

d. Convertible participating mortgages

The System shall make investments in community housing and development projects through the assistance of investment advisors, affiliates, or partners familiar with such transactions.

D. Underwriting Criteria

Underwriting standards shall include demonstrated records of accomplishment in similar projects. Standards shall also include access to additional capital, if necessary, covering potential cost overruns, and no secondary collateral requirements unless essential. Where projects meet the underwriting criteria, the System shall consider pricing concessions to support affordability on a case-by-case basis.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
CORE APARTMENT REAL ESTATE

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous core apartment real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Core Apartment Real Estate Portfolio ("the Portfolio"). The design of this Policy ensures that investors, managers, partners, members, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Portfolio.

II. STRATEGIC OBJECTIVE

Achieving the highest risk adjusted total rate of return possible is the strategic objective of the Portfolio. This objective shall reflect prudent levels of risk, the liabilities of the System, and the investment guidelines contained herein.

The Core Apartment Real Estate Portfolio shall be managed to accomplish the following:

A. Provide diversification;

B. Preserve investment capital;

C. Generate attractive risk-adjusted rates of return for the System;

D. Provide a hedge against inflation;

E. Provide stable cash flow from operations;

F. Provide appreciation potential; and

G. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVES

A. Exceed (after fees) a minimum target real rate of return of 5.0%; and

B. Exceed (before fees) the National Council of Real Estate Investment Fiduciaries Index ("the NCREIF Index") while maintaining an appropriate level of diversification to mitigate risk.

IV. ASSET ALLOCATION

Subject to the Statement of Investment Policy for Equity Real Estate, the following is the current asset allocation range for the Core Apartment Real Estate Portfolio as a percent of the total Equity Real Estate Portfolio:

	Range
Core Apartment Real Estate Portfolio	10 - 35%

From time to time, the actual allocations may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments to correct the actual allocations to comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the System's investment returns, is considered a reasonable time frame.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Diversification

The Portfolio shall reduce risk through appropriate diversification. Diversification shall occur primarily by geography and investment strategy, as outlined below.

1. Diversification by Geography

The Portfolio shall be comprised primarily of investments in the United States. The Portfolio shall contribute to the overall geographic diversification objectives of the Core Real Estate Portfolio as specified in the Statement of Investment Policy for Equity Real Estate.

2. Diversification by Strategy

   The System shall employ a broad range of strategies for apartment property investments. The allocation ranges established for each of the recommended strategies are a percentage of the Core Apartment Real Estate Portfolio listed below. To mitigate risk, the System shall place less emphasis on strategies carrying a greater degree of uncertainty.

Strategy	Allocation Range
Existing Stabilized "Class A" Properties	30 -100%
Existing Stabilized "Class B" Properties	0 - 50%
Existing Value-Added Properties	0 - 10%
Speculative Development	0 - 10%
Land	0 - 5%

   The Senior Investment Officer of Real Estate may allow a specific core property sector to exceed 10% Speculative Development level as long as the **overall** Core Portfolio Speculative Development level **does not** exceed 10%.

3. From time to time, the actual allocations of various geographic sectors and investment strategies may fall out of the ranges prescribed by the Policy. In these instances, the System shall implement adjustments correcting the actual allocations so they comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the investment returns for the System, is considered a reasonable time frame.

4. The Investment Manager may utilize a forward commitment defined as a Presale Investment. A Presale property may be a Class A or Class B Property that is to be constructed (or is under construction) which the Investment Manager contracts to purchase subject to an appropriate criteria such as, completion of construction and receipt of Certificates of Occupancy for all of the apartment units, and or, a minimum lease up requirement.

B. Investment Objectives and Criteria

1. Existing Stabilized "Class A" Properties

   a. "Class A" shall refer to properties of the highest grade based on location, age, and quality of construction and amenities.

   b. Investment objective is to generate cash flow returns with appreciation potential.

   c. Investment Criteria

      (1) Properties shall be newly constructed or substantially renovated within the past 15 years;

      (2) At least 80% occupancy upon acquisition;

      (3) Minimum 150 units size;

      (4) High quality construction;

      (5) A full range of high quality amenities;

      (6) Location shall feature proximity to major employment areas and transportation routes, retail services and other commercial and community services;

      (7) Rental rates shall fall within top 25% of sub-market;

      (8) Each property shall produce a minimum five-year real IRR (after fees) of 5%;

      (9) Each property shall produce an appropriate risk adjusted return; and

      (10) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

2. Existing Stabilized "Class B" Properties

   a. "Class B" shall refer to assets of a lesser grade compared to "Class A" properties based on location, age, and quality of construction and amenities.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) Properties shall be newly constructed or substantially renovated within the past 20 years;

(2) At least 85% occupancy upon acquisition, with stable history;

(3) Minimum 150 units size;

(4) Quality construction and design, preferably of brick or other more durable materials;

(5) Properties shall feature a range of amenities competitive within this market segment. Typically, fewer amenities than "Class A" apartments;

(6) Locations will feature proximity to major employment areas and transportation routes, retail services, and other commercial and community services;

(7) Rental rates shall fall within the top 50% of sub-market;

(8) Each property shall produce a minimum five-year real IRR (after fees) of 5.5%;

(9) Each property shall produce an appropriate risk-adjusted return; and

(10) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

3. Value-added Properties

a. "Value-added" shall refer to existing properties acquired with the intention of redeveloping, re-leasing or repositioning the properties in some manner to yield higher total returns.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) Properties shall be newly constructed or shall have been substantially renovated within the past 25 years;

(2) Occupancy requirements shall be subject to scope of redevelopment;

(3) Minimum 150 units size;

(4) Properties shall feature a range of amenities competitive within this market segment after completion of redevelopment. Typically, fewer amenities than Class “A” apartments;

(5) Locations shall feature proximity to major employment areas and transportation routes, retail services, and other commercial and community services;

(6) Rental rates shall fall within the top 50% of sub-market after renovation;

(7) Each property shall produce a minimum five-year real IRR (after fees) of 6.5%;

(8) Each property shall produce an appropriate risk-adjusted return; and

(9) Additionally, new acquisitions shall require acceptable initial stabilized cash.

a. Additional Criteria

(1) Value-added properties must be of quality design and construction that can be upgraded to be competitive with newer apartment properties;

(2) Total expenditures to reposition apartment properties should not exceed 30% of replacement cost;

(3) Replacement cost is defined as the estimated cost, to construct at current prices a building with amenities equivalent to the existing buildings using modern materials and current standards, designs, and layouts. The replacement cost includes all direct, indirect, and land costs; and

(4) The System shall acquire properties at substantial discounts to replacement cost.

4. Speculative Development

a. Investment objective is to generate cash flow returns with appreciation potential.

b. Investment Criteria

(1) Age - new construction;

(2) Occupancy - initially none. Developer may have earn-out tied to lease-up when appropriate;

(3) Size - minimum 150 units;

(4) Amenities - range of amenities to be competitive in local market;

(5) Location - proximity to major employment areas and transportation routes;

(6) Rental rates - top 40% of sub-market upon initial stabilization;

(7) Each property shall produce a minimum five-year real IRR of 7.5% (after fees);

(8) Each property shall produce an appropriate risk-adjusted return; and

(9) Additionally, development projects shall require an acceptable initial stabilized cash return.

a. Additional Criteria

(1) Development should only be in markets, which exhibit favorable supply and demand conditions. Markets shall have favorable demographics, limited sites for new development, and a limited supply of investment capital for new construction;

(2) Development shall meet guidelines set forth in the Statement of Investment Policy for Real Estate Development and the Statement of Investment Policy for Equity Real Estate Joint Ventures;

(3) Development activities shall focus on strategic partnerships with quality developers; and

(4) The investment manager shall control designs, amenities, costs, and overall quality of construction projects;

5. Land

a. “Land” shall refer to undeveloped, vacant land intended for, and with the reasonable probability of obtaining zoning for apartment building development.

b. Investment objective is to acquire land intended for development of apartment properties.

c. Investment Criteria

(1) Locations will be selected from supply-constrained markets and strategic in-fill locations within the sub-markets of existing assets accommodating growth;

(2) Entitlements are defined as land acquisitions that meet the following criteria:

(a) Zoned for apartment development;

(b) Free of governmental restrictions to apartment development (including, but not limited to, no-growth initiatives, building moratoriums and conflicts with general plan amendments); and

(c) Reasonably expected to receive site plan approval in the ordinary course of business.

(3) Environmental compliance is met when a satisfactory Phase I environmental report completed prior to land acquisition;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 8.0%; and

(5) Each property shall produce an appropriate risk adjusted return.

C. Bond-financed Apartments

1. General Requirements

Any investment in bond-financed apartment projects shall conform to the System's general criteria for apartment investments. This applies to both existing projects and development projects.

2. Leverage

Due to the peculiar nature of bond-financed apartment projects, the System places no limit on the amount of leverage used at the project level. However, in no event shall the debt exceed 100% of the value of the underlying real estate at time of acquisition.

3. Asset Management

The System shall require that asset management of bond-financed apartment projects is consistent with the requirements for conventional apartment projects.

VI. GENERAL

Unless otherwise noted, investors, managers, consultants, partners, members or other participants selected by the System shall base all calculations and computations on Fair Market Value, as defined by the

Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation for accounting purposes. See Statement of Investment Policy for Equity Real Estate Appraisal and Valuation.

VII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms are referenced in the System's Master Glossary of Terms.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
CORE INDUSTRIAL REAL ESTATE

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous core industrial real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Core Industrial Real Estate Portfolio ("the Portfolio"). The design of this Policy ensures that investors, managers, partners, members, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Portfolio.

II. STRATEGIC OBJECTIVE

Achieving the highest risk-adjusted total rate of return possible is the strategic objective of the Portfolio. This objective shall reflect prudent levels of risk, the liabilities of the System, and the investment guidelines contained herein.

The Core Industrial Real Estate Portfolio shall be managed to accomplish the following:

A. Provide diversification;

B. Preserve investment capital;

C. Generate attractive risk-adjusted rates of return for the System;

D. Provide a hedge against inflation;

E. Provide stable cash flow from operations;

F. Provide appreciation potential; and

G. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVES

A. Exceed (after fees) a minimum target real rate of return of 5.0%; and

B. Exceed (before fees) the National Council of Real Estate Investment Fiduciaries Index ("the NCREIF Index") while maintaining an appropriate level of diversification to mitigate risk.

IV. ASSET ALLOCATION

Subject to the Statement of Investment Policy for Equity Real Estate, the following is the current asset allocation range for the Core Industrial Real Estate Portfolio as a percent of the total Equity Real Estate Portfolio:

	Range
Core Industrial Real Estate Portfolio:	10-35%

From time to time, the actual allocations may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments to correct the actual allocations to comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the System's investment returns, is considered a reasonable time frame.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Diversification

The Portfolio shall reduce risk through appropriate diversification. Diversification shall occur primarily by geography and investment strategy, as outlined below.

1. Diversification by Geography

The Portfolio shall be comprised primarily of investments in the United States. The Portfolio shall contribute to the overall geographic diversification objectives of the Core Real Estate Portfolio as specified in the Statement of Investment Policy for Equity Real Estate.

2. Diversification by Strategy

The System shall employ a broad range of strategies for industrial property investments. The allocation ranges established for each of the recommended strategies are a percentage of the Core Industrial Real Estate Portfolio listed below. To mitigate risk, the System shall place less emphasis on strategies carrying a greater degree of uncertainty.

Strategy	Allocation Range
Existing Warehouse	10-100%
Existing Flex Space	0 - 35%
Existing R&D	0 - 20%
Existing Office Showroom	0 - 10%
Build-to-Suit Development	0 - 15%
Speculative Development	0 - 10%
Land	0 - 5%

The Senior Investment Officer of Real Estate may allow a specific core property sector to exceed the 10% Speculative Development level as long as the **overall** Core Portfolio Speculative Development level **does not** exceed 10%.

3. From time to time, the actual allocations of various geographic sectors and investment strategies may fall out of the ranges prescribed by the Policy. In these instances, the System shall implement adjustments correcting the actual allocations so they comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving investment returns for the System, is considered a reasonable time frame.

B. Investment Objectives and Criteria

1. Existing Warehouse Properties

a. “Warehouse” shall refer to buildings containing at least 50,000 square feet or greater, with a maximum of 15% office space, and the balance having an 18-foot or greater ceiling height. All loading is dock height.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 80% occupancy upon acquisition;

(2) High quality construction with preferably concrete tilt-up or block;

(3) A full range of good-quality amenities, preferably having 22-foot or greater ceiling heights, appropriate ratio of dock doors and bay depths, minimum 110 feet truck-turning area, and fully sprinklered;

(4) Locations will feature proximity to major modes of transportation, including freeways, railways, and airports;

(5) Each property shall produce a minimum five-year real IRR (after fees) of 5%;

(6) Each property shall produce an appropriate risk-adjusted return; and

(7) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

2. Existing Flex Space Properties

a. “Flex Space” shall refer to single story buildings having 10 to 18-foot ceiling heights, with both floor height and dock height loading. Office build-out is typically greater than 15%.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 80% occupancy upon acquisition;

(2) Construction and amenities shall be competitive with the high end of the sub-market. Amenities to include 12 to 18-foot

ceiling heights, appropriate parking ratios, and fully sprinklered;

(3) Locations will feature proximity to major industrial parks and distribution centers;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 5.75%;

(5) Each property shall produce an appropriate risk-adjusted return; and

(6) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

3. Existing Research and Development ("R&D") Properties

a. R&D shall refer to one and two story buildings having 10 to 15-foot ceiling heights, with up to 50% office/dry lab build-out (remainder in wet lab, workshop, storage, and other support), with dock height and floor height loading;

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 85% occupancy upon acquisition;

(2) Construction and amenities shall be competitive with the high end of the sub-market. Amenities include 14 to 20-feet ceiling heights, appropriate parking ratios, and fully sprinklered;

(3) Locations will feature in select major R&D markets able to support high tech businesses;

(4) Each property shall produce a minimum five-year real IRR (after fees) that exceeds 6.00%;

(5) Each property shall produce an appropriate risk-adjusted return; and

(6) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

4. Existing Office Showroom Properties

a. "Office showroom" shall refer to single story (or mezzanine) buildings having 10 to 16-foot ceiling heights with frontage treatment on one side and dock height loading or grade level roll-up on the other. Office build-out is typically less than 15%.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 80% occupancy upon acquisition;

(2) High quality construction with preferably concrete tilt-up or block;

(3) A full range of good quality amenities, preferably having 14-foot or greater ceiling heights, good truck access, appropriate parking ratios, and fully sprinklered;

(4) Locations will feature proximity to major industrial parks and distribution centers;

(5) Each property shall produce a minimum five-year real IRR (after fees) of 5.50%;

(6) Each property shall produce an appropriate risk-adjusted return; and

(7) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

5. Build-to-Suit Development

a. "Build-to-suit" shall refer to a to-be-built industrial property developed for, and leased to, a single tenant with a minimum lease term of five years.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 75% pre-leased occupancy. Developer may have earn-out hurdles tied to lease-up, as appropriate;

(2) Amenities shall be competitive within sub-market;

(3) Locations shall be selected from major regional distribution markets;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 5.25%;

(5) Each property shall produce an appropriate risk-adjusted return; and

(6) Additionally, development projects shall require an acceptable initial stabilized cash return.

d. Additional Criteria

(1) Development is subject to guidelines set forth in the Statement of Investment Policy for Development Investments and the Statement of Investment Policy for Equity Real Estate Joint Ventures;

(2) Development activities shall focus on strategic partnerships with quality developers; and

(3) The investment manager shall control design, amenities, costs and overall quality of construction projects.

6. Speculative Development

a. “Speculative development” shall refer to the construction of buildings, primarily warehouse, leased to one or more tenants with minimal or no pre-leasing.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) No minimum occupancy. Developer may have earn-out hurdles tied to lease-up, as appropriate;

(2) Amenities shall be competitive within sub-market;

(3) Locations shall be selected from major regional distribution markets;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 6.5%;

(5) Each property shall produce an appropriate risk-adjusted return; and

(6) Additionally, new development projects shall require an acceptable initial stabilized cash return.

d. Additional Criteria

(1) Development is subject to guidelines set forth in the Statement of Investment Policy for Development Investments and the Statement of Investment Policy for Equity Real Estate Joint Ventures;

(2) Development activities shall focus on strategic partnerships with quality developers; and

(3) The investment manager shall control design, amenities, costs and overall quality of construction projects.

7. Land

a. “Land” shall refer to undeveloped, vacant land intended for development of industrial buildings.

b. Investment objective is to acquire land intended for development of industrial properties.

c. Investment Criteria

(1) Location shall be selected from supply constrained markets, strategic in-fill locations, and within the sub-markets of existing assets to accommodate growth;

(2) Minimum five-acre parcel size;

(3) Entitlements are defined as land acquisitions that meet the following criteria:

(a) Zoned for industrial development;

(b) Free of governmental restrictions to industrial development (including, but not limited to no-growth initiatives, building moratoriums, and conflicts with general plan amendments); and

(c) Reasonable expectations for receiving site plan approval in the ordinary course of business;

(4) Environmental compliance is met when a satisfactory Phase I environmental report is completed prior to land acquisition;

(5) Each property shall produce a minimum five-year real IRR (after fees) of 7.5%; and

(6) Each property shall produce an appropriate risk-adjusted return.

VI. GENERAL

Unless otherwise noted, investors, managers, consultants, partner members or other participants selected by the System shall base all calculations and computations on Fair Market Value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation for accounting purposes. See Statement of Investment Policy for Equity Real Estate Appraisal and Valuation Policy.

VII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms are referenced in the System's Master Glossary of Terms.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
CORE OFFICE REAL ESTATE

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous core office real estate investment policies.

I. PURPOSE

This document sets forth the investment policy (“the Policy") for the Core Office Real Estate Portfolio (“the Portfolio”). The design of this Policy ensures that investors, managers, partners, members, consultants, or other participants selected by the California Public Employees' Retirement System (“the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Portfolio.

II. STRATEGIC OBJECTIVE

Achieving the highest risk-adjusted total rate of return possible is the strategic objective of the Portfolio. This objective shall reflect prudent levels of risk, the liabilities of the System, and the investment guidelines contained herein.

The Core Office Real Estate Portfolio shall be managed to accomplish the following:

A. Provide diversification;

B. Preserve investment capital;

C. Generate attractive risk-adjusted rates of return for the System;

D. Provide a hedge against inflation;

E. Provide stable cash flow from operations;

F. Provide appreciation potential; and

G. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVES

A. Exceed (after fees) a minimum target real rate of return of 5.0%; and

B. Exceed (before fees) the National Council of Real Estate Investment Fiduciaries Index ("the NCREIF Index") while maintaining an appropriate level of diversification to mitigate risk.

IV. ASSET ALLOCATION

Subject to the Statement of Investment Policy for Equity Real Estate, the following is the current asset allocation range for the Core Office Real Estate Portfolio as percent of the total Equity Real Estate Portfolio:

	Range
Core Office Real Estate Portfolio:	10-35%

From time to time, the actual allocations may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments to correct the actual allocations to comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the System's investment returns, is considered a reasonable time frame.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Diversification

The Portfolio shall reduce risk through appropriate diversification. Diversification shall occur primarily by geography and investment strategy, as outlined below.

1. Diversification by Geography

The Portfolio shall be comprised primarily of investments in the United States. The Portfolio shall contribute to the overall geographic diversification objectives of the Core Real Estate Portfolio as specified in the Statement of Investment Policy for Equity Real Estate.

2. Diversification by Strategy

The System shall employ a broad range of strategies for office property investments. The allocation ranges established for each of the recommended strategies are a percentage of the Core Office Real Estate Portfolio and listed below. To mitigate risk, the System shall place less emphasis on strategies carrying a greater degree of uncertainty.

Strategy	Allocation Range
Existing Office Properties	60 - 100%
Existing Value Added Office Properties	0 - 15%
Build-to-Suit Office Development	0 - 15%
Speculative Office Development	0 - 10%
Land	0 - 5%

The Senior Investment Officer of Real Estate may allow a specific core property sector to exceed the 10% Speculative Development level as long as the **overall** Core Portfolio Speculative Development level **does not** exceed 10%.

3. From time to time, the actual allocations of various geographic sectors and investment strategies may fall out of the ranges prescribed by the Policy. In these instances, the System shall implement adjustments correcting the actual allocations so they comply with the Policy allocation ranges, within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the investment returns for the System, is considered a reasonable time frame.

B. Investment Objectives and Criteria

1. Existing Office Properties

a. Investment objective is to generate cash flow returns with appreciation potential.

b. Investment Criteria

(1) Suburban and Central Business District (CBD) locations;

(2) Minimum investment size of $10 million;

(3) Minimum occupancy - 75% upon acquisition and projected to average 75% during first three years of ownership;

(4) Building age of 20 years or less from original construction or renovation, unless the property achieves rents comparable to buildings no more than 15 years old;

(5) Institutional grade property;

(6) Each property shall produce a minimum five-year real IRR (after fees) of 5%;

(7) Each property shall produce an appropriate risk adjusted return; and

(8) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

2. Existing Value-Added Office Properties

a. "Value-added" shall refer to existing properties, acquired by the System with the intention of redeveloping, re-leasing, or repositioning the properties in some manner so as to yield higher total returns. A value-added office project can be an office property that, at acquisition, is less than 75% leased or projected to be less than 75% leased during the first three years of ownership.

A value-added office project can also be any office project, including existing office, with redevelopment or repositioning budget equal to 20% or more of the Fair Market Value of the property. This excludes land if the project has been held for one year or more, or the cost of investment, excluding land for projects held less than one year.

(1) Reclassification to build-to-suit shall occur when a value- added project is 75% leased for a minimum of five years and 75% of the value-added redevelopment work has been completed (excluding tenant improvements and leasing commissions).

(2) Reclassification to existing office shall occur once a Certificate of Occupancy for the base building and all occupied floors has been obtained, the project is 90% leased, and 90% of the value-added redevelopment work has

been completed (excluding tenant improvements and leasing commissions).

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) Suburban and Central Business District (CBD) locations;

(2) Institutional grade property;

(3) Each property shall produce a minimum five-year real IRR (after fees) of 6.50%;

(4) Each property shall produce an appropriate risk adjusted return; and

(5) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

3. Build-to-Suit Office Development

a. "Build-to-Suit Development" shall refer to a to-be-built office development that is at least 75% pre-leased with a weighted average lease term of at least five years upon commencement of construction.

Reclassification to an existing office project shall occur when a Certificate of Occupancy for the building has been obtained and the project is 90% leased with a weighted average lease term of at least four years.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) At least 75% pre-leasing occupancy;

(2) Suburban and Central Business District (CBD) locations;

(3) Institutional grade property;

(4) Each property shall produce a minimum five-year real internal rate of return ("IRR") (after fees) of 5.75%;

(5) Each property shall produce an appropriate risk adjusted return; and

(6) Additionally, development projects shall require an acceptable initial stabilized cash return.

d. Additional Criteria

(1) Development is subject to guidelines set forth in the Statement of Investment Policy for Real Estate Development and the Statement of Investment Policy for Real Estate Equity Joint Ventures;

(2) Development activities shall focus on strategic partnerships with quality developers; and

(3) Investment manager shall control design, amenities, costs and overall quality of construction projects.

4. Speculative Office Development

a. “Speculative office development” shall refer to the construction of an office building leased to one or more tenants with less than 75% pre-leasing or a weighted average lease term of less than five years.

(1) Reclassification to build-to-suit will occur when the project is almost 75% leased with a weighted average lease term of five years and 75% of the original development work (excluding tenant improvements and leasing commissions) for the project is complete.

(2) Reclassification to existing office will occur once a Certificate of Occupancy for the base building and all occupied floors has been obtained and the project is 90% leased with a weighted average lease term of four years.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) No minimum occupancy;

(2) Suburban and Central Business District (CBD) locations;

(3) Institutional grade property;

(4) A speculative office development project, original build-to-suit office, or value-added office properties shall be reclassified as existing office once the project meets the following criteria:

(a) 90% leased for an average lease term of a minimum of four years;

(b) A Certificate of Occupancy for the base building and all occupied floors; and

(c) 90% of the value-added redevelopment work has been is complete, excluding tenant improvements and leasing commissions (applies to value-added only)

(5) Each property shall produce a minimum five-year real IRR (after fees) of 7.0%;

(6) Each property shall produce an appropriate risk adjusted return; and

(7) Additionally, development projects shall require an acceptable initial stabilized cash return.

d. Additional Criteria

(1) Development is subject to guidelines set forth in the Statement of Investment Policy for Real Estate Development and the Statement of Investment Policy for Real Estate Equity Joint Ventures;

(2) Development activities shall focus on strategic partnerships with quality developers; and

(3) Investment manager shall control design, amenities, costs and overall quality of construction projects.

5. Land

a. "Land" shall refer to undeveloped, vacant land intended for office building development and ancillary related uses (e.g. restaurants).

b. Investment objective is to acquire land intended for development of office properties.

c. Investment Criteria

(1) Locations will be selected from supply-constrained markets and strategic in-fill locations within the sub-markets of existing assets accommodating growth;

(2) Entitlements are defined as land acquisitions that meet the following criteria:

(a) Zoned for office development;

(b) Free of governmental restrictions to office development (including, but not limited to, no-growth initiatives, building moratoriums and conflicts with general plan amendments); and

(c) Reasonably expected to receive site plan approval in the ordinary course of business.

(3) Environmental compliance is met when a satisfactory Phase I environmental report completed prior to land acquisition;

(4) Each property shall produce a minimum five-year real IRR (after fees) of 8.0%; and

(5) Each property shall produce an appropriate risk adjusted return.

VI. GENERAL

A. This Policy contains a glossary of terms in Section VII. of this document.

B. Unless otherwise noted, investors, managers, consultants, partners members, or other participants selected by the System shall base all calculations and computations on Fair Market Value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation for accounting purposes. See Statement of Investment Policy for Equity Real Estate Appraisal and Valuation Policy.

VIII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms are referenced in the System's Master Glossary of Terms.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
CORE RETAIL REAL ESTATE

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous core retail real estate investment policies.

I. PURPOSE

This document sets forth the investment policy (“the Policy”) for the Core Retail Real Estate Portfolio (“the Portfolio”). The design of this Policy ensures that investors, managers, partners, members, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with the Portfolio.

II. STRATEGIC OBJECTIVE

Achieving the highest risk-adjusted total rate of return possible is the strategic objective of the Portfolio. This objective shall reflect prudent levels of risk, the liabilities of the System, and the investment guidelines contained herein.

The Core Retail Real Estate Portfolio shall be managed to accomplish the following:

A. Provide diversification;

B. Preserve investment capital;

C. Generate attractive risk-adjusted rates of return for the System;

D. Provide a hedge against inflation;

E. Provide stable cash flow from operations;

F. Provide appreciation potential; and

G. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVES

A. Exceed (after fees) a minimum target real rate of return of 5.0%; and

B. Exceed (before fees) the National Council of Real Estate Investment Fiduciaries Index ("the NCREIF Index") while maintaining an appropriate level of diversification to mitigate risk.

IV. ASSET ALLOCATION

Subject to the Statement of Investment Policy for Equity Real Estate, the following is the current asset allocation range for the Core Retail Real Estate Portfolio as a percent of the total Equity Real Estate Portfolio:

	Range
Core Retail Real Estate Portfolio:	10-35%

From time to time, the actual allocations may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments to correct the actual allocations to comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the System's investment returns, is considered a reasonable time frame.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Diversification

The Portfolio shall reduce risk through appropriate diversification. Diversification shall occur primarily by geography and investment strategy as outlined below.

1. Diversification by Geography

The Portfolio shall be comprised primarily of investments in the United States. The Portfolio shall contribute to the overall geographic diversification objectives of the Core Real Estate Portfolio as specified in the Statement of Investment Policy for Equity Real Estate.

2. Diversification by Strategy

Retail property types are stratified depending on size, concept, anchor tenant and primary trade areas. The System shall balance the Portfolio within allocation ranges for the three groups of retail formats: Malls, Shopping Centers and Triple Net Leased Assets. The allocation ranges established for each of the recommended retail property types are a percentage of the Core Retail Real Estate Portfolio listed below:

Property Type	Allocation Range
Malls	30 - 100%
Shopping Centers	0 - 65%
Triple Net Leased Assets	0 - 5%

3. Diversification by Strategy for Shopping Centers

The System shall employ a broad range of strategies for shopping center investments. The allocation ranges established for each of the recommended strategies are a percentage of the Shopping Center property type category. To mitigate risk, the System shall place less emphasis on strategies carrying a greater degree of uncertainty.

Strategy	Allocation Range
Existing Shopping Centers	40 - 90%
Build-to-Suit Development	0 - 20%
Value-Added	0 - 20%
Speculative Development	0 - 10%
Major Rehab	0 - 10%
Land	0 - 5%

The Senior Investment Officer of Real Estate may allow a specific core property sector to exceed the 10% Speculative Development level as long as the **overall** Core Portfolio Speculative Development level **does not** exceed 10%.

4. From time to time, the actual allocations of various geographic sectors and investment strategies may fall out of the ranges prescribed by Policy. In these instances, the System shall implement adjustments correcting the actual allocations so they comply with the Policy allocation ranges within a reasonable time frame. Implementation that occurs within a three-year period, with ample consideration given to preserving the investment returns for the System, is considered a reasonable time frame.

B. Investment Objectives and Criteria

1. Malls

a. Malls are defined as retail properties providing an extensive variety of shopping goods, typically consisting of two or more full-line department stores that account for 50-70% of the total area. The mall's total size typically exceeds 800,000 rentable square feet.

b. Investment objective is to generate strong cash flow returns with appreciation potential.

c. Investment Criteria

(1) Dominant properties that are the preeminent retail destinations in their market area;

(2) Joint venture ownership structures with a mall operator to minimize ownership costs and maximize alignment of interest;

(3) Diversification through publicly traded and privately owned assets.

(4) Each property shall produce a minimum five-year real IRR, (after fees) of 5%;

(5) Each property shall produce an appropriate risk-adjusted return; and

(6) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

2. Shopping Centers

a. Existing Shopping Centers

(1). "Existing Shopping Centers" are defined as existing retail properties consisting of less than 800,000 square feet serving a primary trade area of 3 to 10 miles. These include neighborhood, community, power, and specialty centers. Generally, the System shall avoid outlet shopping centers.

(2). Investment objective is to generate cash flow returns with appreciation potential.

(3). Investment Criteria

(a) Institutional grade property;

(b) At least 85% occupancy with a minimum weighted average lease term of five years;

(c) Generally building age of 20 years or less from original construction or renovation;

(d) Locations with supply constraints or high growth characteristics;

(e) Strong locational access and visibility including access to public and private transportation routes;

(f) Dominant anchor tenants with strong credit;

(g) Continuous operating clauses in anchor tenant leases, if attainable;

(h) Maximum ratio of small shop space to total shopping area is generally 35%;

(i) Strong demographics in trade area;

(j) Each property shall produce a minimum five-year real IRR (after fees) of 5%;

(k) Each property shall produce an appropriate risk-adjusted return; and

(l) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

b. Build-to-Suit Development

(1). “Build-to-Suit Development” shall refer to a to-be-built shopping center that is at least 75% pre-leased with a weighted average lease term of at least five years upon commencement of construction.

Reclassification to an existing shopping center shall occur when a Certificate of Occupancy for the building has been obtained and the project is 85% leased with a weighted average lease term of at least five years.

(2). Investment objective is to generate cash flow returns with appreciation potential.

(3). Investment Criteria

(a) At least 75% pre-leasing occupancy;

(b) Institutional grade property;

(c) Locations with supply constraints or high growth characteristics;

(d) Strong locational access and visibility including access to public and private transportation routes;

(e) Dominant anchor tenants with strong credit;

(f) Continuous operating clauses in anchor tenant leases, if attainable;

(g) Maximum ratio of generally 35% small shop space to total shopping area;

(h) Strong demographics in trade area;

(i) Each property shall be required to produce a minimum five-year real IRR (after fees) of 5.75%;

(j) Each property shall be required to produce an appropriate risk-adjusted return; and

(k) Additionally, development projects shall require an acceptable initial stabilized cash return (after completion).

c. Value Added

(1). “Value-added” shall refer to existing properties acquired with the intention of redeveloping, re-leasing, or repositioning the properties in some manner so as to yield higher total returns. A value-added shopping center is a shopping center that at acquisition is at least 75% leased for a weighted average lease term of five years.

Reclassification to existing shopping center shall occur when a Certificate of Occupancy for the building has been obtained and the project is 85% leased with a weighted average lease term of at least five years.

(2). Investment objective is to generate cash flow returns with significant appreciation potential.

(3). Investment Criteria

(a) Locations with supply constraints or high growth characteristics;

(b) Strong locational access and visibility including access to public/private transportation routes;

(c) Strong demographics in trade area;

(d) Each property shall produce a minimum five-year real IRR (after fees) of 5.75%;

(e) Each property shall produce an appropriate risk-adjusted return; and

(f) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

d. Speculative Development

(1). "Speculative Development" shall refer to the construction of a shopping center with less than 75% pre-leasing with a weighted average lease term of at least five years.

Reclassification to an existing shopping center shall occur when a Certificate of Occupancy for the building has been obtained and the project is 85% leased with a weighted average lease term of at least five years.

(2). Investment objective is to generate cash flow returns with appreciation potential.

(3). Investment Criteria

(a) Institutional grade property;

(b) No pre-leasing requirement;

(c) Locations with supply constraints or high growth characteristics;

(d) Strong locational access and visibility including access to public and private transportation routes;

(e) Dominant anchor tenants with strong credit;

(f) Continuous operating clauses in anchor tenant leases, if attainable;

(g) Maximum ratio of generally 35% small shop space to total shopping area;

(h) Strong demographics in trade area;

(i) Each property shall produce a minimum five-year real IRR (after fees) of 7.0%;

(j) Each property shall produce an appropriate risk-adjusted return; and

(k) Additionally, development projects shall require an acceptable initial stabilized cash return (after completion).

(4). Additional Criteria

(a) Development is subject to guidelines set forth in the Statement of Investment Policy for Real Estate Development, and the Statement of Investment Policy_for Real Estate Equity Joint Ventures;

(b) Development activities shall focus on strategic partnerships with quality developers; and

(c) The investment manager shall control the design, amenities, costs, and overall quality of construction projects.

e. Major Rehabilitation

(1) "Major Rehabilitation" shall refer to existing properties acquired with the intention of redeveloping, re-leasing, or repositioning the properties in some manner, so as to yield higher total returns. A major rehabilitation shopping center can be defined in the following two ways:

(a) A shopping center that at acquisition is, or is projected to be, less than 75% leased for a weighted average lease term of five years; or

(b) Any shopping center with a redevelopment budget equal to 20% or more of Fair Market Value. This excludes land if the project has been held for one year or more, or the cost of the investment excluding land if the project has been held less than one year.

Reclassification to an existing shopping center shall occur when a Certificate of Occupancy for the building has been obtained and the project is 85% leased with a weighted average lease term of at least five years.

(2). Investment objective is to generate cash flow returns with appreciation potential.

(3). Investment Criteria

(a) Locations with supply constraints or high growth characteristics;

(b) Strong locational access and visibility including access to public and private transportation routes;

(c) Strong demographics in trade area;

(d) Each property shall produce a minimum five-year real IRR (after fees) of 6.5%;

(e) Each property shall produce an appropriate risk-adjusted return; and

(f) Additionally, new acquisitions shall require an acceptable initial stabilized cash return.

f. Land

(1). “Land” shall refer to undeveloped, vacant land intended for development of shopping centers.

(2). Investment objective is to acquire land intended for development of shopping centers.

(3). Investment Criteria

(a) Locations will be selected from supply-constrained markets, strong residential development areas, and strategic in-fill locations;

(b) Entitlements are defined as land acquisitions that meet the following criteria:

(i) zoned for retail development;

(ii) free of governmental restrictions concerning retail development (including, but not limited to, no-growth initiatives, building moratoriums, and conflicts with general plan amendments); and

(iii) reasonably expected to receive site plan approval in the ordinary course of business.

(c) Environmental compliance is met when a satisfactory Phase I environmental report is completed prior to land acquisition;

(d) Each property shall produce a minimum five-year real IRR (after fees) of 8.0%; and

(e) Each property shall produce an appropriate risk-adjusted return.

3. Triple Net Leased Assets

a. Existing freestanding retail buildings leased to single operators contractually responsible for all operation and maintenance costs of the property.

b. Investment objective is to generate cash flow returns with appreciation potential.

c. Investment Criteria

(1) 100% occupancy;

(2) Ten-year minimum lease term;

(3) Tenants' credit ratings to be examined.

(4) Each property shall produce a minimum five-year real IRR (after fees) of 5%; and

(5) Each property shall produce an appropriate risk adjusted return.

VI. GENERAL

A. This Policy contains a glossary of terms in Section VII. of this document.

Unless otherwise noted, investors, managers, consultants, partners members or other participants selected by the System shall base all calculations and computations on Fair Market Value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation for accounting purposes. See Statement of Investment Policy for Equity Real Estate Appraisal and Valuation Policy.

VII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms are referenced in the System's Master Glossary of Terms.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
ENHANCED CORE INDEX PUBLIC REAL ESTATE EQUITY SECURITIES
(ENHANCED CORE PREES)
INTERNALLY MANAGED

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous Passive Public Real Estate Equity Securities (Passive PREES) - Internally Managed Policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Enhanced Core Index Public Real Estate Equity Securities (Enhanced Core PREES) - Internally Managed ("the Portfolio" or "the Fund"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the Portfolio.

II. STRATEGIC OBJECTIVES

The real estate securities market is a growing and dynamic segment of the capital markets. Unique advantages of these instruments in a diversified investment program include the following:

A. Exposure to real estate segments that are not available through the direct or private market,

B. Liquid, efficient and cost-effective exposure to real estate generally, and

C. The unique risk and return characteristics reflective of the favorable tax treatment for REITs at the corporate level and the resulting distribution of income in the form of dividends, which is especially attractive to a tax-exempt investor.

D. REITs provide investors with a strong corporate governance structure.

Though an attractive investment, this segment of the capital markets is changing constantly as it matures. Therefore, an investment in real estate securities should be reflective of this changing environment and be sufficiently flexible to capture opportunities as they occur. The Enhanced Core PREES Index portfolio is such an opportunity.

The strategic objectives of the Fund are to accomplish the following:

A. Provide broad exposure to solely the core property types of office, industrial, apartment and retail (shopping centers and regional malls) in a publicly traded form;

B. Enhance the real estate investment program by accessing real estate opportunities only available in the public securities market;

C. Provide a complement to the direct real estate investment segment in managing the asset allocation to the core property types within the overall real estate program; and

D. Provide an investment vehicle that is managed to accomplish the following:

1. Enhance the System's total return;

2. Manage liquidity needs of the real estate program;

3. Hedge against active (pre-retirement) liabilities;

4. Provide diversification to the System's overall investment policy; and

5. Consider solely the interest of the System's participants and their beneficiaries in accordance with California State Law.

III. RESPONSIBILITIES AND DELEGATIONS

A. The System's **Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment Committee delegates the responsibility for administering the Fund to the Investment Staff through the Delegation of Authority (Delegation Nos. 89-13 and 95-50).

B. The System's **Investment Staff's** ("the Staff") duties include, but are not limited to, the following:

1. Developing and recommending the Policy to the Investment Committee.

2. Developing and maintaining Program Guidelines, subject to periodic reviews and updates, outlining Staff operational procedures used in implementing this Policy.

3. Implementing and adhering to the Policy.

4. Purchasing only securities that are outlined in the Policy.

5. Reporting to the Investment Committee, as needed, about the performance of the Fund. The Staff shall monitor the implementation of, and compliance with, the Policy. The Staff shall report concerns, problems, material changes, and all violations of Guidelines and Policies immediately and in writing to the Investment Committee.

6. Reporting internally to senior management on this Policy. This report will be prepared monthly to include, but is not limited to, the following information:

   a. Current market value of the portfolio; and

   b. Performance of the portfolio versus the benchmark as reported by the master custodian.

7. Determining the sub-sector weights in an attempt to outperform the benchmark index in accordance with Policy Section V. Investment Approach and Parameters, Subsection B. Asset Allocation.

C. The **General Pension Consultant** ("the General Pension Consultant") is responsible for the following:

1. Monitoring and evaluating the Fund's performance relative to the benchmark and Policy. The General Pension Consultant shall report to the Investment Committee on a quarterly basis, in accordance with its contract.

2. Constructing and maintaining the core index ("Core Index") and providing the Index to Investment Staff on a timely basis.

IV. PERFORMANCE OBJECTIVES

To meet or exceed the custom CalPERS Enhanced Core PREES Real Estate Securities Index and to contribute to the Equity Real Estate Program's out performance of the NCREIF Index are the performance objectives of this Policy.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Implementation

The Public Markets Group shall construct a portfolio of real estate securities in an enhanced index manner to track the per annum return of the Core Index reflecting the target month-end weights of each sub-sector within 1.5% per annum return deviation. The construction of the Portfolio shall include the transaction costs and performance associated with the asset allocation changes made in accordance with Policy Section V. Implementation, Subsection B. Asset Allocation. The return deviation amount shall be re-examined at the annual reconstitution. As this market continues to develop and liquidity improves, transaction costs should decline thus improving the ability to manage tracking error. It is further recognized that standard index construction treats dividends as re-investable as of the ex-dividend date and contains no residual cash equivalents, all of which can affect the performance of a live portfolio. Furthermore, the investment return calculation of the sub-sector may vary from the internal rate of return approach used by the master custodian bank. The Public Markets Group will manage these factors to minimize their impact on tracking error.

An enhanced index approach shall be used to create a portfolio of stocks that mirror the performance of the Core Index. The weight of each security in the Portfolio shall be close to the weight of each security in the Core Index.

B. Asset Allocation

The allocation to the Portfolio will be established as part of the Annual Investment Plan process for CalPERS Real Estate Portfolio. In any event, the Enhanced Core Index Public Real Estate Equity Securities (Enhanced Core PREES) will not violate current equity allocation ranges as set forth in the Statement of Investment Policy for Equity Real Estate.

The allocation to the sub-sectors shall be weighted according to the normalized policy weight, which is each sub-sector's market value weight in the Core Index, unless the allocation is varied at the prudent direction of the Senior Investment Officer, Real Estate.

The circumstances under which this may occur include, but are not limited to, the following:

1. More attractive valuation in the public versus the direct market for a particular property type;

2. More attractive valuation of one property type versus another;

3. To accommodate cash flow targeted to real estate awaiting direct investment; and

4. To complement exposures in the direct core real estate program.

Variances in allocation to various property types from the normalized policy weights shall be reported to the Investment Committee quarterly.

C. Trading Activity

Trading activity shall result from rebalancing each sub-sector of the Portfolio and management of corporate actions described above. Trading activity shall occur as often as necessary to maintain the security weights in line with that of the Core Index.

Trading activity may also result from the impact of corporate actions that affect the Core Index (e.g., mergers and recapitalizations). Each corporate action shall be managed on a case-by-case basis to maintain adherence to the minimization of tracking error.

Trading activity shall also result from asset allocation decisions to vary the sub-sector weights in the Portfolio from their normalized target weights. A variety of trading techniques and liquidity sources shall be utilized to obtain best execution. Crossing networks and other informationless trading techniques may be used along with private placement investments and acquisition of stocks as part of a sale of properties to a publicly traded real estate company.

Trading costs shall be independently measured quarterly by a third-party vendor to ensure proper trading activity management.

D. Over/Under Weighting Report

An over/under weight report shall be generated monthly to display the weight of all stocks in the portfolio relative to the normalized target weight in the Core Index. Stocks shall be screened and evaluated for possible actions to decrease/increase their weight to rebalance the portfolio toward the benchmark weights. Ranges for over/under weighting of sectors will be established by the Senior Investment Officer – Real Estate. Monthly, the Program shall be reviewed to evaluate the impact of varying the sub-sector weights in the Portfolio versus the total return of the Core Index.

E. Permissible Securities

1. Securities, which are contained in the Core Index, that are headquartered in either the US or Canada.

2. The Portfolio may hold securities that are not represented in the designated benchmark. Such holdings are justified on the basis of the following:

    a. Liquidity constraints or excessive transaction costs, e.g., those required to sell certain securities obtained from corporate actions or from past benchmark reconstitutions.

    b. Expectation of inclusion in the benchmark at the next annual reconstitution.

F. Restrictions

1. Any security position which represents more than 5% of the outstanding shares of that security shall be liquidated as soon as it is cost effective to do so to avoid SEC reporting requirements and liquidity constraints.

2. No more than 10% of total index or portfolio holdings may consist of foreign real estate companies (exclusive of Canadian holdings).

3. Diversified securities that are defined as “Diversified” by Wilshire Associates with more than 10% in non-core

property type holdings on a revenue basis will be excluded during the annual index reconstitution.

4. Diversified securities with less than 70% concentration in one of the core portfolio type holdings based on revenues will be excluded during the annual index reconstitution.

VI. BENCHMARK

The benchmark for the CalPERS Enhanced Core PREES Index (the Index) shall be NCREIF and will be measured in a manner in which the core portfolio is monitored. The Index will contain only the securities representing the four core real estate property types, as follows: office, industrial, apartment and retail (shopping centers and regional malls). The Index shall be further segregated into five sub-sectors each representing the four specified core property types (with retail broken into two sectors). The Index will be independently calculated according to the construction rules by the General Pension Consultant. The rules of construction of the Index are described below.

A. Securities Universe

The universe of real estate securities shall be screened once a year (the annual reconstitution) for those securities comprising the four core property types, as defined by the Wilshire Real Estate Securities Index. The securities shall be further segregated into the property type categories to establish five property type sub-sectors. Securities with more than 10% in non-core property type holdings on a revenue basis shall be excluded during the annual index reconstitution. Securities will be included in one of the five property type sub-sectors based on its predominant property type (i.e., at least 70% of its holdings in that property type).

B. Liquidity Test

The securities in the sub-sectors shall be screened for sufficient liquidity to support institutional investment. Since the real estate securities market is changing constantly, the determination of liquidity sufficiency shall be determined each year in coincidence with the anniversary of the Index reconstitution. That determination, to be expressed in terms of a minimum market capitalization, which may vary by property type sub-sector, shall be codified in the Program Guidelines.

The factors to be considered to determine sufficient liquidity may include, but will not be limited to, the following:

1. Average daily trading volume;

2. Outstanding market capitalization;

3. Bid-ask spread relationships;

4. The number and diversity of market makers; and

5. Sufficient operating history to ensure continuance as going concerns and the professional judgment of the Senior Investment Officers for Public Markets and Real Estate.

The analysis supporting their determination of the discrete market capitalization cut-off shall be codified in the Program Guidelines. Any stock not meeting both the market capitalization and the liquidity test in that year shall be excluded from the Index. The remaining eligible securities shall be weighted according to market capitalization.

C. Asset Allocation

The allocation to the five sub-sectors to create the normalized weighted index shall be determined by the relative market value of the combined securities that make up each sub-sector.

D. Reconstitution

The Portfolio shall be reconstituted annually as of June 30 for potential additions and deletions to the index. The Index shall be adjusted for material corporate actions and changes in outstanding shares. Corporate actions will include Initial Public Offerings and private market acquisitions. Treatment of corporate actions shall consider the same factors used to develop the CalPERS Internally Managed Domestic Equity Index (Policy, Guidelines, and Procedures, Section VI. Investment Approach and Parameters, Subsection E. Corporate Actions and are incorporated herein by reference.

VII. GENERAL

A. This Policy contains a Glossary of terms in Section VIII of this document.

B. Investors, managers, consultants, partners, members, or other participants selected by the System shall make all calculations and computations on a market value basis as recorded by the System's Custodian.

VIII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms are referenced in the System's Master Glossary of Terms.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF ACCOUNTING POLICY

FOR
EQUITY REAL ESTATE - ACCOUNTING POLICY

April 24, 1998

This Policy is effective immediately upon adoption and supersedes all previous real estate investment accounting policies.

I. PURPOSE

This document sets forth the accounting policy ("the Policy") for Equity Real Estate ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the Program.

II. ACCOUNTING GOALS AND OBJECTIVES FOR EQUITY REAL ESTATE

The System shall regularly monitor its individual asset and portfolio investment performance against pro forma, industry benchmarks and adopted objectives. To achieve meaningful comparisons, the System shall require accurate and timely accounting information to use as a basis for measuring performance.

III. ACCOUNTING POLICY FOR EQUITY REAL ESTATE

Accounting procedures shall be based on the standards adopted by the National Council of Real Estate Investment Fiduciaries (NCREIF), as applicable. NCREIF bases its standards upon Generally Accepted Accounting Principles (GAAP) as promulgated in the United States, except where industry measurement standards dictate an alternative approach. Additionally, the System shall apply these accounting procedures uniformly across the entire fund, including real estate. Where NCREIF, GAAP, and the System's standards conflict, the System's standards shall prevail.

Financial information shall be obtained on a regularly scheduled basis from the various third-party investment managers who manage real estate investments on behalf of the System. Recognizing the importance of receiving consistent and uniform financial results, third-party investment managers shall take care to achieve reporting standardization, in compliance with the System's other real estate policies and NCREIF standards, as applicable. Where significant differences exist between the manner in which financial information is provided to the System by third-party real estate investment managers and the System's reporting standards, such differences shall be disclosed.

Specific accounting requirements shall be maintained in the Real Estate Equity Managers and the System's Staff Accounting Procedures Manual. The System's Investment Accounting and Real Estate units shall strive for consistency with each other's policies and procedures. Changes to the requirements for investment advisors and the System's staff, as applicable, shall be communicated in writing to the System's Investment Committee and Independent Auditors.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
EQUITY REAL ESTATE APPRAISAL AND VALUATION

April 15, 2002

This Policy is effective immediately upon adoption and supersedes all previous real estate appraisal policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Equity Real Estate Appraisal and Valuation ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the markets.

II. STRATEGIC OBJECTIVE

The System shall regularly monitor its individual asset and portfolio investment performance against pro forma, industry benchmarks, and adopted objectives and policies. The Staff shall receive assistance in measuring and verifying asset performance annually through an independent appraisal of market value for each investment in the Core Equity Real Estate Portfolio. The Staff, at their discretion, shall schedule appraisals within a given year, occurring on a rolling four-quarter basis. The Real Estate Appraisal Review and Performance Reporting Program shall select appraisers appropriate to perform valuations on the real estate investments.

III. INVESTMENT APPROACHES AND PARAMETERS

A. Appraisal Policy

1. Appraisals shall conform with the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation. Accordingly, the appraisals shall provide a market value estimate of the System's specific interest in real estate assets. Market value should be based on the

USPAP definition; therefore market value should reflect the most probable selling price for the System's interest given a reasonable exposure period, and assuming a willing and knowledgeable buyer and seller.

2. The System's interests may include 100% owned, partial interests, joint ventures, general or limited partner interests, mortgagor or mortgagee, ground lessor, or some form of participating debt.

3. The System's interest should be valued on an unleveraged basis, unless such leverage is considered favorable (below market) and would be assumable by the purchaser.

4. An appraisal of the market value of the System's interests should consider the depth, or lack thereof, of a market for that type of interest, the profile of the most likely buyers, and an understanding of how these interests are priced in the relevant market. If appropriate, premiums or discounts should be analyzed and supported which address issues such as control, marketability, minority or majority interests, right of first refusal, purchase options, preferred returns, and so forth. Market participant interviews and published survey data shall support appropriate rates of return.

5. Certain properties may be exempt from the process under the following conditions and at the Staff's discretion:

   a. Property with a very low risk profile (e.g., single tenant supermarkets).

   b. Property marketed for sale or under contract for sale.

   c. Property held for less than one year.

6. Reputable firms, utilizing staff who are Members of the Appraisal Institute (MAI designation), shall be engaged to prepare the appraisals. Property assignments shall be rotated every five years or earlier depending on the quality of service and product, or other situations indicating a prudent change should occur. Rotation also gives the System a new perspective in the market, as well as preventing any appraisal firm from becoming too dependent on past market assumptions and valuations. The System's Staff Procedures Manual shall contain criteria for selection of appraisers.

B. Valuation Policy

1. The System shall report the market value as indicated in the System's most recent appraisal or as determined through the appraisal process outlined below.

2. The System shall use the Appraisal Arbitration Process outlined within this section in settling valuation disputes at the end of a contract period.

3. The appraisal process will follow the succeeding steps:

   a. The System will engage an appraisal firm for completing an appraisal of the property at the termination of the contract period.

   b. Upon review of the appraisal, either the System or the Investment Manager may initiate the following appraisal arbitration process.

      Appraisal Arbitration Process

      1) Either the System or the Investment Manager(s), at their own expense, may obtain a second appraisal using an appraiser from the System's approved list of appraisers. The election to obtain another appraisal must be made within 15 days of the event triggering the determination of the Project's fair market value.

      2) If the second appraisal does not differ from the System's initial appraisal by more than 5%, then the average of the two appraisals shall be considered the market value of the property.

      3) If the second appraisal differs by more than 5% from the System's initial appraisal, the two appraisers who prepared the appraisals shall meet and determine the market value of the property. If the two appraisers cannot agree upon a value within 30 days of the date of the last appraisal, they shall select a third appraiser from the list of the System's approved appraisers within 30 days of the date of the last appraisal.

4) If the appraisers cannot agree on the market value, they shall select a third appraiser from the Approved List to perform a third appraisal. An average of the three appraisals shall be considered the market value of the property. If, however, the lowest appraisal or the highest appraisal or both differ by more than 5% from the middle appraisal, then such low or high or both appraisals shall be disregarded. The average of the remaining appraisals or the remaining appraisal, if both are disregarded, shall be considered the market value of the property. Both Investment Managers shall share equally the expense of the third appraisal.

c. If upon termination of the initial contract period, the current contract shall not be renewed and therefore the property shall be transferred to new management, the following additional process shall also be employed.

Initial Valuation at the Beginning of an Investment Management Relationship

The new manager shall review the appraised value of the property as determined above in Section III.B.3.b. If the new advisor agrees with this value, no further action is necessary and this value becomes the beginning value for the purposes of the new contract. However, if the new manager or the System disagrees with the new value, they shall follow the succeeding process:

1) The System shall instruct the outgoing Manager(s) to market the property for sale using a third-party brokerage firm to broadly solicit offers (“Market Offers”) from the market.

2) The new Investment Manager shall submit a value (“New Manager Bid”) for the property to the System. The System shall not share the New Manager Bid with the outgoing manager.

3) The System shall determine its own bid (“Hold Value”), which is—the value that it would

continue to hold the asset as an investment (and not sell below).

4) Upon completion of the marketing process, the System shall compare the Market Offer, the New Manager Bid, and its Hold Value.

5) If the highest value among these three values is the New Manager Bid, the System shall retain its ownership of the asset and transfer the management of the asset to the new Investment Manager. The value of the asset will equal the New Manager Bid for the purposes of both the final valuation of the outgoing manager and the initial valuation for the new manager.

6) If the Market Offer, based on the estimated net sales proceeds, is the highest of these three values, the System shall instruct the outgoing manager to complete the sale of the asset. Thus the final net proceeds of sale determines the final value in the outgoing manager's contract.

7) If the System's Hold Value is the highest of these three values, the System shall retain the asset and arrange for the management of the asset at its own discretion. The value of the asset in this instance shall equal the appraised value of the asset.

C. Specialized Portfolio

This appraisal policy shall apply to Core and Non-Core Equity Real Estate Portfolios, if applicable, that may require fair market valuations as defined by the Uniform Standards of Professional Practice (USPAP) of the Appraisal Institute.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
EQUITY REAL ESTATE

April 14, 2003

This Policy is effective immediately upon adoption and supersedes all previous equity real estate portfolio policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Equity Real Investment Portfolio ("the Portfolio"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the real estate market.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return possible, consistent with a prudent level of risk and the liabilities of the System, and the investment guidelines contained herein is the strategic objective of the Portfolio.

The Portfolio shall be managed to accomplish the following:

A. Provide diversification to the System's overall investment program;

B. Preserve investment capital and generate attractive risk-adjusted rates of return for the System;

C. Provide a hedge against inflation; and

D. Consider solely the interest of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVE

The Portfolio shall be managed over the long term to accomplish the following:

A. Exceed (after fees) a minimum real rate of return of 5.0%; and

B. Exceed (before-fees) the National Council of Real Estate Investment Fiduciaries Index ("NCREIF Index") while maintaining an appropriate level of diversification to mitigate risk.

IV. BENCHMARK

The benchmark for the Portfolio will be the total rate of return of the composite NCREIF Index (before fees).

V. GENERAL

A. This Policy contains a glossary of terms in Section XVII. of this document.

B. All calculations and computations shall be based on fair market value unless otherwise noted.

VI. ASSET ALLOCATION

The asset allocation target and range for the Portfolio shall comply with the guidelines included in the Strategic Asset Allocation Policy. Adjustments from actual to target allocation shall be implemented within a time frame consistent with the provisions set forth in the Strategic Asset Allocation Policy.

VII. INVESTMENT APPROACHES AND PARAMETERS

A. Prudent Expert Standard

The selection of real estate investments shall be guided by the "prudent expert" standard, embracing the prudent decision making process typically employed by experts in the areas of real estate acquisition, development, operation, disposition, and portfolio management.

B. Diversification Principle

The principle of diversification in portfolio theory is defined as "The reduction of risk without a corresponding reduction of return." This shall be accomplished through the investment of capital among a variety of management organizations, strategies, asset types, and sub-markets, based on the guidelines contained herein. The Portfolio shall be diversified within reasonable tolerance bands regarding investment strategies, property types and locations, and investment structures, among other factors.

C. Natural Resource Use and Conservation Measures

CalPERS encourages the prudent use and conservation of natural resources. When commercially reasonable and economically feasible, consideration shall be given to the implementation of technologies, both proven and new, that promote conservation, and reduce operating costs or provide other tangible benefits.

VIII. CORE AND SPECIALIZED PORTFOLIO SUB-CLASSIFICATIONS

A. Strategic Objectives

The Portfolio is divided into two segments: the Core Portfolio and the Specialized Portfolio, based on risk and return characteristics. The strategic objective of the Core Portfolio is to produce stable current income and market level returns commensurate with a low-to-moderate level of risk. The strategic objective of the Specialized Portfolio is generally to produce higher returns than the Core Portfolio, thereby increasing the overall performance of the Equity Real Estate Portfolio, subject to an incrementally greater amount of risk. Allocations to the Core and Specialized Portfolios shall be made to maximize the overall return to the Equity Real Estate Portfolio while mitigating risk.

B. Allocation of the Equity Real Estate Portfolio between Core and Specialized Portfolios:

The Core Portfolio will comprise 50 - 80% of the target allocation to the Equity Real Estate Portfolio. The remaining 20 - 50% of the target allocation to the Equity Real Estate Portfolio will comprise the Specialized Portfolio. However, given that sometimes there may be differences between the target and actual allocation to the Equity Real Estate Portfolio, the Specialized Portfolio shall be limited to no more than 50% of the actual allocation to the Equity Real Estate Portfolio. The allocation ranges for the Core and Specialized Portfolios may also be adjusted from time to time for risk management purposes.

As investments in the Specialized Portfolio mature, their characteristics may migrate towards a more core-like profile. The Consultant shall monitor the Equity Real Estate Portfolio for instances when changes in the classification of investments from the Specialized to the Core Portfolio are warranted. The Consultant will make recommendations to the Investment Committee for approval of such reclassifications.

C. Core Portfolio

1. Target Return and Benchmark

The Core Portfolio has a long-term target real rate of return of 5.0% (after fees) and is expected to produce market level returns over time, with a commensurate level of risk. Hence, its performance is expected to mirror the composite NCREIF Index on before-fee basis.

2. Diversification and Allowable Investments

The Core Portfolio shall be well diversified by property type and geography. Generally, investments shall be limited to office, retail, industrial, and apartment properties. Typical Core Portfolio properties shall exhibit “institutional” qualities. They shall be well located within their local and regional markets, of high-quality design and construction. Generally, the Core Portfolio shall be well occupied, though a limited portion may be invested in properties undergoing redevelopment, new construction, or significant re-leasing at any time. Development of Core Portfolio properties (as well as properties contained in the Specialized Portfolio) shall be subject to guidelines included in the Statement of Objectives and Policies for Development and the Statement of Objectives and Policies for Equity Joint Ventures.

3. Use of Leverage

Limited use of leverage is permissible in the Core Portfolio to enhance investment returns. Sufficient consideration shall be given to the impact of debt financing on the risk and return characteristics of the leveraged investments and the Core Portfolio, in total. Use of leverage shall be subject to guidelines contained in the Statement of Equity Real Estate Leverage Policy.

D. Specialized Portfolio (Non-Core)

1. Investment Strategy

The Specialized Portfolio consists generally of investments with expected returns in excess of the Core Portfolio and above market risk along with specifically targeted investments with generally acceptable returns. These investments are often found in “niche” opportunities (e.g., timber, hotels, and so forth) or exist because of inefficiencies in the real estate or capital markets. Additionally, the Specialized Portfolio may contain investments in special purpose properties with a narrow user market (e.g., mobile home parks). Investment strategies for the Specialized Portfolio shall be characteristically “opportunistic”, based on prevailing market conditions at the time of investment. Specific policies shall be developed to take advantage of new investment opportunities as they arise.

2. Target Return and Benchmark

The Specialized Portfolio has a target real rate of return exceeding 5.0% commensurate with the risk profile of the asset. Within the Specialized Portfolio, expected returns may vary considerably, based on differences in investment program strategies and structures, and the level of risk associated with each program, among other factors. Additionally, investments included in the Specialized Portfolio are likely to generate limited current income. The bulk of the return on these investments is expected to come from appreciation. Some programs may employ moderate-to-high levels of leverage to augment investment performance (e.g., Single Family Housing Development). Specific return objectives and performance benchmarks shall be established for each of the investment programs included in the Specialized Portfolio.

IX. PERMISSIBLE INVESTMENTS

A. Equity real estate investments may include direct or indirect equity investments in real estate, including all rights and interests incident thereto. The following is a list of such investments:

1. Interests in corporations, partnerships and other entities whose primary business is the acquisition, development and operation of real property including publicly-traded or private Real Estate Investment Trusts (“REITs”) and real estate operating companies (aka “PREES”). Investments in REITs and real estate operating companies shall be made subject to the Statement of Internally Managed Public Real Estate

Equity Securities (Active PREES) Investment Policy, Guidelines and Procedures (Section VI.F.4);

2. Co-investment with other institutional investors;

3. Participating or convertible participating mortgages or other debt instruments convertible into equity interests in real property based on investment terms (and not merely by foreclosure upon default). Investments in debt with equity features shall be made subject to the Statement of Objectives and Policy for Hybrid Debt Investments;

4. Options to purchase real estate, leaseholds, and sale leaseback's, subject to the Statement of Objectives for Sale-Leaseback Investments; and

5. All other real estate related securities such as lower or unrated tranches of pre-existing securitized or structured debt instruments such as mezzanine debt, with equity features.

B. Leveraged equity investments are permissible subject to the Statement of Equity Real Estate Leverage Policy.

C. Joint venture investments are permitted. Joint venture equity partners may include both institutional investors (passive investors) and owner-developer/manager entities (active investors). Joint venture investments shall be subject to the provisions set forth in the Statement of Objectives and Policies for Real Estate Equity Joint Ventures.

D. Properties and reversionary interests in properties may be acquired subject to ground leases.

E. International investments are permitted for the Specialized Portfolio given appropriate review of the experience and strength of potential investment management organizations, and the real estate and capital markets, practices, and laws of countries selected, among other factors. The Core portfolio may invest internationally limited to Canada and Mexico upon the approval of the Senior Investment Officer. Investment in Canada and Mexico combined will be restricted to 20% of each Core partner's allocation, with a maximum of 10% in Mexico. International investments shall comply with the requirements included in the Statement of Objectives and Policy for International Real Estate Investment.

International investments done through the Core portfolio, in Canada and Mexico, may be accounted for through the Core portfolio for allocation purposes and must adhere to the Statement of Investment Policy for International Real Estate Investments. Investments in Canada and Mexico within the Core portfolio will be subject to appropriate alignment of interests and risk-adjusted returns. Partners must receive specific written approval for investments in Canada and Mexico on a deal-by-deal basis subject to approval of the Senior Investment Officer. Strategies, including investments in Canada and Mexico by Core partners shall be stated in their respective Annual Plans.

F. Restrictions and Prohibitions

On occasion, the System may determine that certain investment strategies are not suitable. Appendix I of this Policy contains a list of investment programs.

X. INVESTMENT APPROACHES AND PARAMETERS

A. Core Portfolio

1. Diversification by Property Type and Recommended Allocation

To reduce risk, the Core Portfolio shall be well-diversified by property type. Allocation ranges for the basic property types to be included in the Core Portfolio are as follows:

Property Type	Allocation Range
Office	25 - 40%
Retail	20 - 35%
Industrial	15 - 35%
Apartment	10 - 30%
Land	0 - 3%

Whenever feasible or practical, multiple-use properties, such as retail/office complexes, shall be allocated between the property type categories listed above based on investment value attributed to each use.

Investments in Core Portfolio apartment, industrial, office, and retail properties shall be subject to the provisions set forth in the Statement of Objectives and Policies for Core

Apartment Investments, the Statement of Objectives and Policies for Core Industrial Investments, the Statement of Objectives and Policies for Core Office Investments, and the Statement of Objectives and Policies for Core Retail Investments.

In limited instances, land may be acquired in connection with the purchase of improved property. The land may be contiguous with the improved property or in the immediate area or subdivision of the property. The land may be held if an expansion of the existing property or new development is anticipated. Separate purchases of land are also permissible provided that such acquisitions are for future development as well. In either event, direct holdings of land should not comprise more than 3% of the Core Portfolio.

The System's land holdings shall be accounted for separately from the other property type categories noted above, unless the land is undergoing development. In such cases, the land component along with development costs shall be included for performance measurement purposes in the relevant property sector component.

2. Diversification by Geography and Recommended Allocation

To reduce risk, investments in the Core Portfolio shall be predominantly located in the United States and well diversified by geography. Based on the geographic classification system used in the NCREIF Index, the Core Portfolio will be divided into four regions. Allocation ranges for the four regions are as follows:

Property Type	Allocation Range
West	25 - 40%
East	15 - 30%
South	15 - 30%
Midwest	10 - 25%

For the Core portfolio, investments in Canada and Mexico may be approved subject to appropriate alignment of interests, risk-adjusted returns and compliance with the Statement of Policy for International Equity Real Estate (see Section IX.E.)

The distribution of states by region is included in Appendix II.

Additional consideration shall be given to diversification of the Core Portfolio by Primary Metropolitan Statistical Area (PMSA). Focus shall be placed on the primary industries supporting each metropolitan area. In no event shall more than 10% of the Core Portfolio be located in any single Primary Metropolitan Statistical Area (PMSA).

While there are no specific guidelines for diversification based on exposure to geographies having similar economic profiles or industry concentrations or both, the Core Portfolio shall be prudently diversified in this aspect.

3. Diversification by Individual Asset Size

For asset and risk management purposes, the Core Portfolio shall be diversified by asset size. Portfolio acquisitions shall be balanced by asset size according to the market value of the System's investment in the asset and the asset's physical size. Neither small nor large investments should dominate the composition of the Core Portfolio. The value of individual investments shall generally be no less than $10 million and no greater than $200 million, though exceptions can be made. In any event, no single asset should exceed 10% of the value of the Core Portfolio at any time. Smaller properties may be combined (such as a portfolio of industrial buildings) such that the aggregate investment size of the group of properties exceeds $10 million.

4. From time to time, the actual allocations to the various property and geographic sectors may not fall within the ranges prescribed by Policy. In these instances, adjustments from actual to the Policy allocation ranges shall be implemented over a reasonable period (normally within a three-year period). Ample consideration shall be given to preserving investment returns to the System.

B. Specialized Portfolio

The Specialized Portfolio shall be sub-divided based on investment program (e.g., timber, franchise finance).

The Investment Committee shall review and approve strategies for programs included in the Specialized Portfolio. Programs shall also be administered subject to the adoption of specific investment policy guidelines for each program. Appendix III of this Policy contains a list of existing Specialized Portfolio Investment Programs polices.

XI. REAL ESTATE VALUATION

The System's investments in equity real estate shall be valued at least annually on a fair market value basis. In certain circumstances, when it is inappropriate or not possible to value investments at market, an alternate method of valuation shall be used.

XII. STRATEGIC AND ANNUAL PLANS

A. Strategic Plan

A strategic plan shall be prepared for the Equity Real Estate Portfolio ("the Strategic Plan"). The Strategic Plan will set forth the System's long-term objectives for investment and management of the Portfolio. The Plan shall include an implementation plan based on the Portfolio's sub-classifications, the Core and Specialized Portfolios; property sub-divisions of the Core Portfolio (i.e., the Apartment, Office, Retail, and Industrial); and various investment programs contained within the Specialized Portfolio. The Strategic Plan shall be updated periodically.

B. Annual Plan

An annual plan shall be prepared for the Portfolio detailing the current status of the Portfolio and outlining expectations for the coming year toward meeting various objectives included in the Strategic Plan ("the Annual Plan"). The Annual Plan shall be based on input from each of the System's investment management organizations. The Annual Plan shall also contain an overview of emerging real estate opportunities.

XIII. PERFORMANCE MEASUREMENT

A comprehensive performance measurement report for the Portfolio shall be prepared on a quarterly basis ("the Performance Report"). The Performance Report shall contain historical time-weighted and internal rates of returns for each of the System's investment management organizations. Additionally, a comparison shall be made of each investment's actual internal rate of return to its objective. Returns shall be aggregated, along with information on investment attributes, on a total portfolio basis and based on the various sub- classifications of the Portfolio, as outlined in this document. Comparisons shall be made of actual results to the Portfolio benchmark, investment parameters, and other guidelines or objectives contained in this and other policy statements relating to the Portfolio. Furthermore, the Performance Report shall address the impact of the Portfolio performance on the System's total portfolio return. Lastly, the Performance Report shall contain information on significant events impacting the Portfolio.

XIV. SELECTION, MONITORING, EVALUATION, AND TERMINATION OF INVESTMENT MANAGEMENT ORGANIZATIONS

A. Selection of Investment Management Organizations

The System seeks to retain investment management organizations possessing superior capabilities in asset management. With this objective, prospective managers shall be evaluated for selection based upon, but not limited to the following criteria:

1. The suitability of the organization's investment plan relative to the Equity Real Estate Portfolio's investment guidelines and objectives;

2. The quality, stability, integrity, and experience of the management team;

3. The ability and willingness of the organization to dedicate sufficient resources and personnel to optimally manage the System's investments;

4. The reasonableness of investment terms and conditions including provisions to align interests of management and the System; and

5. The appropriateness of management controls and reporting systems, among other factors.

B. Monitoring, Evaluation, and Termination of Investment Management Organizations

The primary objective of ongoing monitoring and evaluation of investment management organizations is to ensure that each manager provides satisfactory performance of their duties and complies with various obligations set forth in their contract.

The System's investment management organizations shall be monitored and evaluated on an ongoing basis based on their performance relative to stated objectives and benchmark, and the performance of firms managing similar investments in the marketplace. Additionally, investment management organizations shall be monitored for compliance with investment guidelines, policies, and procedures of the System and other contractual provisions. Consideration shall also be given to the financial strength of the investment management organization, the level of client service given the System and changes within the managing organization; for example, the continuity of personnel assigned to the System's investments shall be reviewed, among other items. At least once yearly, the System's investment management organizations shall a written evaluation based on the above-mentioned criteria. Management organizations found to be deficient relative to the System's standards shall be placed on "watch list status". Management organizations placed on the System's watch list status that fail to cure their deficiencies in a reasonable time period may be terminated.

Specific guidelines for monitoring, evaluating, and terminating organizations managing investments for the Portfolio are included in the Equity Real Estate Portfolio's External Manager Monitoring Program Policy.

XV. RESPONSIBILITIES AND DELEGATIONS

The Portfolio shall be managed through the coordinated efforts of the Board, Investment Committee, Staff, Consultant, investment management organizations, and Legal Counsel. Delegation of the responsibilities of each participant shall be set forth in the Real Estate Delegation & Approval Guidelines.

XVI. REVIEW AND MODIFICATION OF INVESTMENT POLICY STATEMENT

This Policy shall be reviewed periodically to determine if modifications are necessary or desirable.

XVII. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

Appreciation Return - is the percentage change in the market value of a property or portfolio, adjusted for capital improvements and partial sales, over a period of analysis.

Bond Financed Project - is a development project, which is or was partially funded through the use of government-issued tax-free bonds. The interest cost on such bonds is typically less than that of traditional financing. Development of apartments with a significant proportion of “low-income housing” is a common type of bond-financed project.

Co-Investment - refers to investments where the management organization has a capital investment and ownership share.

Convertible Mortgage - is an investment structure wherein the lender (the System) receives mortgage interest and an option to convert a portion or all of the loan balance into equity.

Convertible Participating Mortgage - is an investment structure wherein the lender’s (the System) return consists of mortgage interest plus potential contingent interest expressed as a percentage of property operating cash flow and/or property appreciation upon sale or refinancing and where the lender has an option to convert a portion or all of the loan balance into a percentage of equity.

Direct Investment - is an investment in which the System has ownership interest in a property or group of properties.

Equity Participation Feature - is a debt instrument in which the lender (the System) either has claims to contingent interest (in the form of additional cash from operations or capital appreciation) or equity conversion rights.

Equity Real Estate - refers to real estate investments in which the investor (the System) has an ownership interest. The term is generally used in contrast with conventional mortgage investments.

Fair Market Value - is the highest price a property would bring if exposed for sale in the open market by a willing seller to a willing buyer with both parties to the transaction being fully informed of all the uses and purposes to which the property is reasonably adaptable and available.

Ground Lease - is a lease that grants the right to use and occupy land for a stated term. Ground leases exist in situations where the investor (the System) owns the real estate improvements but does not own the land underlying the improvements.

Income Return - is the component of return derived from property or portfolio operations during a period of analysis, expressed as a percentage of property market value.

Indirect Investment - is an investment in which the System has an ownership interest in an entity (e.g., a corporation) which primarily invests in real properties.

Leasehold - is the right to use and occupy real estate for a stated term and under certain conditions. Leasehold interest is conveyed by a lease.

Leverage - is the use of fixed-cost funds (or debt) to acquire or develop an income-producing property.

Leveraged Equity Investment - refers to investments in real estate in which the investor “the System” has an equity interest and the purchase or ownership of the investment is or partially financed with debt.

National Council of Real Estate Investment Fiduciaries Index (“NCREIF Index”) - is a property level performance benchmark for institutionally owned real estate. The benchmark is composed of an Income Return, an Appreciation Return and a Total Return and is calculated on a quarterly basis.

Participating Mortgage - is an investment structure wherein the lender’s (the System) return consists of mortgage interest plus potential contingent interest expressed as a percentage of property operating cash flow and/or property appreciation upon sale or refinancing.

Primary Metropolitan Statistical Area (“PMSA”) - is a geographic unit used by the Bureau of the Census for reporting consolidated demographic and economic information. Each PMSA consist of a large urbanized county or cluster of counties that demonstrates very strong internal economic and social links, in addition to close ties to other portions of a larger urbanized area or CMSA (Consolidated Metropolitan Statistical Area).

Public Real Estate Equity Securities (“PREES”) - are real estate securities, including Real Estate Investment Trusts (REITS) and real estate C corporations, whose stocks are publicly-traded.

Real Estate Investment Trust (“REIT”) - refers to a private or publicly traded company which typically invests in income-producing properties and which qualifies as an REIT under Sections 856-860 of the Internal Revenue Code of 1986. As an REIT, a company must distribute to its shareholders at least 95% of its taxable income and is not subject to federal (and typically state) income tax to the extent income is distributed, among other requirements.

Real Rate of Return - is a nominal return adjusted to exclude the impact of inflation.

Risk-Adjusted Rate of Return - is the Total Return adjusted for volatility of returns over time. That is, for two investments having an equal Total Return over an investment period, that investment which experiences the least volatility of returns has the higher risk-adjusted rate of return. The standard calculation of risk-adjusted rate of return is the “Sharpe Ratio” defined as the difference between the investment return and the average

T-bill rate over the same period, divided by the standard deviation of the investment return over the period.

Sale Leaseback - is a financing arrangement in which an owner-user sells a property to a buyer (the System) and then simultaneously arranges to lease the property back from the buyer for continued use.

Total Return - is the sum of the Appreciation Return and Income Return.

Appendix I

Prohibited Investments

Any investment prohibited by the System's Insider Trading Policy and Restricted Company list.

Appendix II

Distribution of States by NCREIF Regions and Sub-regions

West Region	Midwest Region	East Region	South Region
Mountain *Arizona* *Colorado* *Idaho* *Montana* *Nevada* *New Mexico* *Utah* *Wyoming*	**East North Central** *Illinois* *Indiana* *Michigan* *Ohio* *Wisconsin*	**Northeast** *Connecticut* *Maine* *Massachusetts* *New Hampshire* *New Jersey* *New York* *Pennsylvania* *Rhode Island* *Vermont*	**Southeast** *Alabama* *Florida* *Georgia* *Mississippi* *Tennessee*
Pacific *Alaska* *California* *Hawaii* *Oregon* *Washington*	**West North Central** *Iowa* *Kansas* *Minnesota* *Missouri* *Nebraska* *North Dakota* *South Dakota*	**Mideast** *Delaware* *District of Columbia* *Kentucky* *Maryland* *North Carolina* *South Carolina* *Virginia* *West Virginia*	**Southwest** *Arkansas* *Louisiana* *Oklahoma* *Texas*

Appendix III

Policy List for Specialized Portfolio Investment Programs

- Statement of Investment Policy for Specialized Equity Real Estate
- Statement of Investment Policy for Franchise Finance Real Estate
- Statement of Investment Policy for International Real Estate
- Statement of Investment Policy for Agricultural Land Real Estate
- Statement of Investment Policy for California Urban Real Estate
- Statement of Investment Policy for Timber Real Estate
- Statement of Investment Policy for Single Family Housing Program
- Statement of Investment Policy for Active Public Real Estate Equity Securities (Active PREES).
- Statement of Investment Policy for Senior Housing

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
EQUITY REAL ESTATE JOINT VENTURES**

November 13, 2001

This Policy is effective upon adoption and supersedes all previous joint venture policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Equity Real Estate Joint Ventures Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and capturing returns associated with this segment of the market.

This Policy applies to existing and future joint ventures. However, a number of existing joint ventures do not comply with the Policy. In cases where existing joint ventures do not comply, all efforts shall be used to restructure such agreements and otherwise manage the investment to maximize return notwithstanding existing limitations. A list of non-compliant joint ventures shall be maintained in the Staff Procedures Manual.

II. STRATEGIC OBJECTIVE

The System shall make joint venture investments in equity real estate ("Joint Ventures") under specified conditions and circumstances as described in this Policy.

Joint Ventures in existing properties shall achieve a minimum long-term real rate of return consistent with the overall return objectives of the Equity Real Estate Portfolio ("the Portfolio") and the overall risk of the particular investments. Joint Ventures in development projects shall be expected to achieve higher returns due to increased risks. In either case, investment selection shall be oriented to the preservation of capital and achievement of real rates of return.

III. INVESTMENT POLICY

The System's Real Estate Investment Managers may negotiate Joint Ventures with the following types of co-venturers:

A. Developers

B. Institutional Investors/Owners

C. REITS

D. Limited Liability Companies

E. Operating Companies

However, terms and conditions of a Joint Venture agreement ("Agreement") are subject to prior approval by the System's Senior Real Estate Investment Officer and General Counsel or designated counsel.

Joint Ventures may be direct co-investments in existing, substantially leased or development properties, in accordance with policies established in the System's Statement of Investment Objectives and Policies for Development Investments.

Joint Ventures may be structured as limited liability companies, limited partnerships, corporations, REITS, and other formats. Additionally, Joint Ventures shall be subject to the investment policies in accordance with the System's Statement of Investment Objectives and Policies for the Equity Real Estate Portfolio.

A. **Leverage**

Regarding core assets only, leveraged Joint Ventures are permitted to the extent that sufficient financial and pragmatic consideration is given to the increased risk and return characteristics for the investment of the underlying debt financing. The System shall make decisions for entering into leveraged Joint Ventures or for leveraging a Joint Venture in accordance with its Statement of Equity Real Estate Leverage Policy.

B. **Distributions**

The basis of distributions (e.g., net cash flow, net income, or gross income) shall be carefully defined in the Agreement(s) governing the Joint Venture, with the understanding that the basis of such allocation shall take into consideration the relative equity investment, management and oversight responsibilities and tax positions of the joint venturers. Distributions shall be paid at least quarterly, and preferably on a monthly basis. The System generally prefers distributions based on income after expenses, net of a provision for reserves for payment of property taxes and anticipated repairs and capital improvements.

C. **Contributions**

The Agreement shall specify the amount, extent and timing of each joint venturer's contribution (in property, cash, credit, or services) to the Joint Venture. It is anticipated that a managing joint venturer shall have capital at risk that is material to that joint venturer. Both joint venturers shall make additional contributions in proportion to their ownership percentages or as stated in the Agreement. If a joint venturer is unable to meet its contribution requirement, such an event shall generally be treated as a default, and the Agreement shall provide for remedies.

In cases where the System has both equity and debt investment in the Joint Venture, the Agreement shall provide that the System is not obligated to provide additional contributions to fund debt service payments. However, the System shall have the ability to do so if the additional contributions preserve its right as a lender.

D. **Responsibilities of Joint Venturers**

All Agreements shall specify the roles and responsibilities of each of the joint venturers. Responsibilities shall include executing asset management decisions for the Joint Ventures, overseeing or providing daily property management services, reporting results to others, and other specific services.

E. **Resolution of Disputes**

Provision for resolution of disputes among joint venturers shall be specifically defined in the Agreement. Alternative means of resolution for different types of disputes shall be specified in the Agreement(s), along with the respective rights and responsibilities of the various participants.

F. **Transfer of Interests**

Joint venturers may transfer their interests to another joint venturer or to third parties. The Agreement shall provide the System with a right of first offer, and the right to approve new joint venturers. The

System shall seek to obtain a right of first refusal, which would apply in the event the System's co-venturer desires to sell its interest. Conversely, the System shall avoid granting its co-venturer a right of first refusal. It shall do so only after full consideration of the impact on the marketability, and ultimately the value, of the System's interest. The System must retain the right to buy out its co-venturer(s) in Joint Venture agreements and shall consider incorporating a buy/sell agreement where necessary to ensure this right.

G. **Construction Overruns**

For development Joint Venture projects, the System shall have the right to approve the proposed construction budget and shall negotiate provisions to minimize the impact of possible cost overruns on the System in the Agreement. However, in some cases, it may be appropriate for the System to fund approved construction cost overruns, although the System shall not be obligated to contribute.

H. **Investment Control**

The System shall seek to obtain a controlling interest in Joint Ventures in order to have the greatest possible degree of control over its investment. The System shall retain a level of control over property management and major decisions consistent with its economic interest in the investment.

IV. ASSET MANAGEMENT

The Investment Manager or an affiliate may be the System's partner in a Joint Venture. Alternatively, the Investment Manager may be a third party retained to represent the System in a Joint Venture. In either role, the Investment Manager shall act as a fiduciary to the System when representing the System's interest as its asset manager in the Joint Venture. In this case, the fee structure for property management services shall require the approval of the System's staff. If the property manager is affiliated with the System's Investment Manager, the fee structure for property management services shall require the approval of the System's staff. Asset and property management may be transferred from the Investment Manager to another of the System's Investment Managers, or a third party, at the sole discretion of the System's Senior Real Estate Investment Officer.

Reporting and accounting procedures for the Joint Venture must be established to meet the System's current reporting and accounting standards and policies. The System shall have the right to have independent certified audits of the Joint Venture accounting records and property documents. The Agreement shall require that the managing partner provide the System with enough information for adequately tracking the performance of the assets in the Joint Venture as well as the System's interest.

Joint Venture properties shall be insured under the System's Risk and Insurance Program if the System deems it to be the most extensive and cost efficient insurance coverage obtainable.

The System reserves the right to review the selection of the Joint Venture's attorney, accountants, consultants, and other third-party advisors, with the System retaining the right as co-venturer to review and approve all documents prepared by outside parties.

V. SELECTION OF JOINT VENTURERS

Potential development company, limited liability corporation, and operating company joint venturers are to be evaluated by the System's Investment Manager based on past development and asset management experience with similar projects, and financial stability. Potential institutional investor and REIT joint venturers are to be evaluated based on their size, financial stability, alignment of interests with the System, and commitment to a long-term real estate investment.

VI. DEVELOPMENT FEES

Payment of development fees to developer joint venturers shall be subject to negotiation and may reflect reimbursement of overhead costs and reasonable profit. Approval of actual development fees to developer joint venturers shall be at the sole discretion of the System's Senior Real Estate Investment Officer.

VII. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

Right of First Refusal: Within the context of a joint venture, this is a right giving one owner of a property or position (Owner "A") a first chance to buy the property or position if another owner (Owner "B") decides to sell. Owner "B" must have a legitimate offer with specific terms and conditions, which Owner "A" has the option to match consummating the purchase of the property or position. If Owner "A" refuses, the property or position can then be sold under said terms and conditions.

Right of First Offer: Within the context of a joint venture, this is a right giving one owner of a property or position (Owner "A") a first chance to buy the property or position if another owner (Owner "B") decides to sell. If Owner "A" refuses to make an offer, the property or position can then be sold to a third party. If Owner "A" makes an offer and Owner "B" rejects the offer, the property or position can be sold, generally limited to a price no less than Owner "A's" offer, or some negotiated percentage of the offer from Owner "A".

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
EQUITY REAL ESTATE LEVERAGE

February 18, 2003

This Policy is effective upon adoption and supersedes all previous real estate investment leverage policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Equity Real Estate Leverage Program. The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Equity Real Estate Leverage Program ("the Program"). Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the market.

II. STRATEGIC OBJECTIVE

The System shall employ a prudent use of leverage in the real estate portfolio to enhance investment returns with full consideration of the impact of such leverage on overall investment risk. Leverage at property, portfolio, and corporate levels shall be acceptable with a preference for the most efficient and flexible borrowing structure available. The required rate of return on leveraged investments shall reflect the increase in investment risk due to the use of leverage.

III. REAL ESTATE LEVERAGE POLICY

A. Debt Limitations

1. Private Core Real Estate Portfolio

Specific terms of leverage agreements shall vary according to market conditions. However, the consolidated principal amount of leverage on the private portion of the Core Real Estate Portfolio shall not exceed 50% of the System's share of the gross market value of the investment. Staff shall have the right to allocate a higher leverage level than 50% to a core sector as long as the overall Core Portfolio leverage does not exceed 50%. Notwithstanding the above, any leverage above 40% placed on the Core Portfolio must first be approved by the System's Real Estate Consultant and the Chief Investment Officer. Approval of any debt to be placed by our Partners/Managers must be pre-approved by Staff. Consolidated leverage shall include all types of financing without limitation, property-specific debt, tax-exempt bond financing, construction financing, and portfolio level financing. If the consolidated leverage ratio exceeds 50% for any reason, the Investment Manager shall use all reasonable efforts to reduce such leverage to the 50% level within a maximum cure period of one year. The Investment Committee shall receive reports concerning any exception regarding leverage in the Real Estate Quarterly Performance Report. The annual investment plan, promulgated by the investment manager and approved by the System, shall govern the use of financing proceeds. The debt service coverage ratio shall measure no less than 1.75:1 for portfolio-level debt and no less than 1.25:1 for property-level debt. The ratio measures the amount of annual cash flow available for making payments on borrowings relative to the annual debt service obligation.

2. Public Real Estate Securities Portfolio

Public Core real estate investments may also include leverage at levels consistent with market conditions. Public real estate securities shall be considered Specialized when leverage has a material impact on overall investment risk.

3. Specialized Real Estate Portfolio

Leverage may be employed in the Specialized Real Estate Portfolio at higher levels to enhance investment returns. The level of leverage shall be specified for each of these investments prior to approval. The increased risk associated with higher levels of leverage shall be considered in establishing acceptable rates of return.

B. Collateral

Borrowings may be structured in public or private, and secured or unsecured formats; however, recourse shall be limited in all cases to the real estate investments in the portfolio. The System shall not guarantee such financing without specific approval from the Investment Committee. Acceptable collateral includes, but is not limited to, the System’s wholly owned direct equity real estate or the System’s partnership or joint venture interest.

C. Origination

The System, its partners or investment managers, or third parties may arrange borrowings. Origination costs will vary with market conditions. To the extent that the System, its partners, or investment managers arrange borrowings, the following shall apply:

1. Unaffiliated third parties are not precluded from providing such services;
2. The cost of such services is at market rate; and
3. The System shall approve, in advance, the use of affiliates, the services provided, and the terms thereof.

D. Term/Rate Structures

Terms of leverage structures shall not exceed 30 years for conventional financing and 40 years for tax-exempt or Federal National Mortgage Association (Fannie Mae) or Federal Home Loan Mortgage Corporation (Freddie Mac) financing.

Interest rate structures may include fixed or variable/floating interest rates and amortizing or non-amortizing structures. Hedging techniques to control interest rate risk may be used including, but not limited to interest rate swaps, interest rate caps, and collars. Prudent use of both fixed and variable/floating interest rate structures are appropriate in a dynamic real estate portfolio under the following circumstances:

1. Fixed rate structures are generally used on stabilized properties (i.e., those properties that are producing a fairly stable income stream). In environments where interest rates approach or move toward historical low points, longer terms are generally most appropriate. As interest rates move towards higher historical levels, shorter terms are more appropriate, if leverage is used at all.

2. Variable/floating interest rate structures are generally used on development and value enhanced projects, and in situations where flexibility is needed, such as when a stabilized asset is being positioned for sale.

The appropriate ratio of fixed versus variable/floating debt is dependent upon the strategy, the life cycle of the program, the assets being financed and the position of the overall historical market interest rate cycle. While a fixed rate structure offers protection against interest rate increases, it is less flexible due to the heavy prepayment penalties that lenders usually require. Variable or floating interest rate structures offer lower interest rates up front and generally the flexibility to prepay debt without a prepayment penalty, but they are subject to rising market interest rates over time. Thus, active management of portfolio debt structures is crucial and becomes more important as the amount of leverage increases within a portfolio.

E. Prepayment Provisions and Collateral Flexibility

Where prepayment provisions are necessary, would generally be preferred over lock-in and yield maintenance requirements. It is important within fixed rate structures to negotiate substitution collateral rights and/or one time assumption rights in order to prevent loans from becoming due on sale when disposing of individual real estate assets.

F. Risks and Risk Mitigation

Inherent in the use of leverage are risks which require active prudent debt management. The following are the major risks and some risk mitigation techniques:

1. Volatility Risk: Increasing the portfolio leverage will increase the portfolio's volatility, magnifying both positive and negative changes in appreciation/depreciation. During a market cycle in which real estate values are declining, the higher the leverage carried in a portfolio, the more negative the total return to the portfolio may be. Thus, overall leverage levels should be monitored constantly, particularly during depreciating property market cycles. The less leverage utilized within a portfolio, the less volatile the portfolio will be. Since leverage serves to magnify all systematic or market risks intrinsic in each asset class, this added volatility can not be totally eliminated.

2. Refinancing Risk: Refinancing risk arises when a loan becomes due. If market interest rates are higher and/or property values are declining when loans mature, refinancing options become limited. This may create the need for increased liquidity in the portfolio. That is, additional equity could be required invested at a time when real estate could be at or above its target allocation. Actively managing the amount of debt that matures in a single year by staggering debt maturities should reduce this risk within a portfolio. Also, maintaining debt service coverage ratios

above policy or market minimum underwriting requirements will enhance the ability to rollover debt at its maturity.

3. Default Risk: In a recession or in a market cycle when real estate values are declining, a property's Net Operating Income may decrease, thereby, increasing the risk of a loan default. Additional liquidity needs could result if CalPERS is forced to cure defaults. That is, additional equity could be required invested at a time when real estate could be at or above its target allocation. Actively managing overall leverage levels, debt service coverage levels, pruning poorer performing assets and operating above minimum policy or market underwriting requirements should reduce default risk.

IV. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

Debt Service Coverage - The annual Net Operating Income (NOI) divided by the annual debt service.

Leverage (Debt) - All types of financing with respect to the System's real estate investments, including, but not limited to, property-level financing, construction financing, portfolio-level financing, bond financing, and secured or unsecured corporate debt on real estate companies.

Leverage Ratio - The System's share of consolidated debt divided by the System's share of fair market value of gross assets.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
EXTENDED MARKET PUBLIC REAL ESTATE EQUITY SECURITIES
(EXTENDED MARKET PREES)

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous active PREES policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Extended Market PREES Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, partners, members, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of publicly held real estate.

II. STRATEGIC OBJECTIVE

A. The real estate securities market is a growing and dynamic segment of the capital markets. Institutional investors have recognized the unique advantages of these instruments in a diversified investment program, which include the following:

1. Exposure to real estate segments that are not available through the direct or private market;

2. Liquid, efficient and cost-effective exposure to real estate generally;

3. The unique risk and return characteristics reflective of the favorable tax treatment for REITs at the corporate level and the resulting distribution of income in the form of dividends, which is especially attractive to a tax-exempt investor; and

4. Publicly traded real estate securities and REITs provide investors with a strong corporate governance structure.

B. An investment in real estate securities should reflect this changing environment and be sufficiently flexible to capture opportunities as they occur. The Extended Market PREES portfolio ("the Portfolio") shall provide the System with an opportunity to capture superior returns to the Enhanced Core PREES by allowing an active approach as well as giving flexibility in exit strategies for the Direct Real Estate Portfolio. The Portfolio shall be included as a component of the Specialized (Non-Core) Equity real estate portfolio and, as such, shall be required to achieve an appropriate risk-adjusted return in excess of the Enhanced Core PREES Portfolio held in the core component (Section VI.F. 5).

The strategic objectives of an active investment in PREES are as follows:

1. Provide broad exposure to the specialized (non-core) property type in a publicly traded forum and to other core equity securities, which may or may not be included in the Enhanced Core PREES Index.

2. Enhance the real estate investment program by accessing specialized (non-core) real estate opportunities that are only available in the public securities market.

3. Provide a complement to the direct real estate investment segment in managing the asset allocation to the specialized (non-core) property types and niche opportunities within the overall real estate program.

4. Provide an active approach for investing in both core and specialized (non-core) PREES.

5. Enhance exit strategies for core and specialized (non-core) real estate assets.

III. RESPONSIBILITIES AND DELEGATIONS

A. **The System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment Committee delegates the responsibility for administering the real estate equity portion of the Policy through Delegations of Authority Nos. 89-13 and 95-50.

B. **The System's Investment Staff** ("the Staff") duties include, but are not limited to, the following:

1. Developing and recommending the Policy to the Investment Committee;

2. Developing and maintaining Program Guidelines, which is subject to periodic review and updating, outlining Staff operational procedures to be used in implementing this Policy;

3. Implementing and adhering to the Policy;

4. Reporting immediately to the Investment Committee all violations of the Policy with explanations and recommendations;

5. Reporting to the Investment Committee concerning the performance of the Program on a quarterly basis and monitoring implementation of, and compliance with, the Policy. The Staff shall report all violations of the Policy to the Investment Committee, along with explanations and appropriate recommendations for corrective action; and

6. Reporting internally to senior management concerning the implementation of this Policy. This report will be prepared monthly to include, but is not limited to, the following:

   a. Current market value and allocations by asset;

   b. Aggregate and individual publicly held real estate equity portfolio characteristics;

   c. Performance of the portfolio versus the benchmark.

C. The **General Pension Consultant** ("the General Pension Consultant") is responsible for the following:

   1. Monitoring and evaluating the Portfolio's performance relative to the benchmark and Policy. The General Pension Consultant shall report to the Investment Committee on a quarterly basis, in accordance with its contract.

   2. Constructing, maintaining and providing the indices to Investment Staff on a timely basis.

IV. PERFORMANCE OBJECTIVE

The performance objective of the Portfolio is to contribute to the Equity Real Estate Program's out performance of the National Council of Real Estate Investment Fiduciaries (NCREIF) Index.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Approaches

1. The Portfolio shall be invested to maximize return, within acceptable risk parameters, through the selection of publicly traded equity securities available in United States equity markets and non-United States markets, if appropriate and consistent with permissible countries policy.

2. The Program shall be implemented through internal management, where appropriate competencies exist and where the System's Investment Committee has granted approval to do so.

3. The program may also be implemented through the use of external managers and consultants or both.

4. The Program shall identify opportunities across the real estate equity securities market and invest where risks are both understood and manageable, while maintaining asset quality, liquidity, and performance. Equally important for management of the real estate portfolio is flexibility in managing asset mix by specific security selection. This flexibility is expected to add incremental value versus a passive approach.

5. The Program shall track, manage, and exercise warrants, options, and other derivatives held within the Equity Real Estate portfolio.

6. The Program shall allow the System to enhance its flexibility in the exit strategy of real estate assets by acquiring PREES shares and liquidating them at the prudent direction of the Senior Investment Officer for Real Estate (SIO-RE).

B. Asset Allocation

1. The current asset allocation range for the Portfolio, as a percent of the total real estate equity allocation, is from 0 to 15% based on market values. In any event, the Extended Market Public Real Estate Equity Securities (Extended Market PREES) allocation will not violate current equity allocation ranges as set forth in the Statement of Investment Policy for Equity Real Estate.

   From time to time, the actual investment may fall out of the ranges prescribed by Policy. In these instances, adjustments to correct the actual to comply with the Policy allocation ranges shall be implemented on an opportunistic basis during a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

2. The allocation within the range to the Portfolio shall be at the prudent direction of the SIO-RE. The factors considered in asset allocation and selection shall include, but are not limited to, the following:

   a. The difference in valuation in the public versus the direct market for a particular property type or company;

   b. The ability to complement exposures in the direct real estate program;

   c. The ability to facilitate a sale of property to a publicly traded real estate company or Real Estate Investment Trust (REIT);

   d. Niche opportunities presented in the public market;

   e. The benefit derived from partnerships with publicly owned companies who are managing the System's assets that demonstrate excellent growth prospects; and

   f. The benefit of acquiring options and other derivatives in real estate transactions with publicly traded companies. Holdings in derivatives shall comply with all applicable derivative and equity policies.

3. The asset selection process shall include, but not be limited to, analysis of the following factors:

   a. Liquidity, including average daily trading volume, outstanding market capitalization, bid-ask spread relationships, the estimated transaction cost of investing various dollar amounts, the number and diversity of market makers, and sufficient operating history to ensure continuance as going concerns;

   b. Investment strategy;

   c. Operating history;

   d. Governance and control;

   e. Real estate asset analysis; and

   f. Other analysis as necessary in the prudent and professional judgment of the SIO-RE.

C. Implementation

1. The Public Markets group shall construct a portfolio of real estate securities in an active manner. The discretion to buy or sell shall be at the prudent direction of the SIO-RE, but shall be supported by market analysis prior to execution.

2. Trading activity will result from the execution of portfolio allocations made by the SIO-RE and will occur as often as necessary to maintain the desired positions of each security.

3. The acquisition of stocks/derivatives may result as part of a sale of property to a publicly traded real estate company.

4. A variety of trading techniques and liquidity sources shall be utilized to obtain best execution. Crossing networks and other informationless-trading techniques may be used along with private placement investments.

5. Trading costs shall be independently measured no less than quarterly by a third-party vendor to ensure proper trading activity management.

6. The portfolio shall be reconstituted annually as of June 30 for potential additions and deletions to the index.

D. Permissible Investments

1. Securities that are contained in the Enhanced Core PREES Index.

2. Securities that constitute the Wilshire Real Estate Securities Index.

3. Securities which are companies in partnership or strategic alliances with the System in managing and owning real estate.

4. Securities that do not qualify for Enhanced Core PREES Index due to specialized (non-core) property holdings, market capitalization or other reasons; nevertheless, they present a niche opportunity and provide a complement to the real estate portfolio.

5. Securities or derivatives received in exchange for sale of real property or other transactions.

6. Existing holdings of the System that the System desires to manage and hold within this Program and Policy.

E. Restrictions

1. Any security position that represents more than 5% of the outstanding shares of that security shall not be held so as to avoid SEC reporting requirements and liquidity constraints. Liquidation shall be sought as soon as it is cost effective to do so.

2. No more than 10% of total portfolio holdings may consist of non-U.S. real estate properties (exclusive of Canadian holdings).

VI. BENCHMARK

The benchmark shall be the Wilshire Real Estate Securities Index ("WRESI"). Actively managed accounts will have performance criteria custom designed to reflect the investment strategy and risk profile.

VII. GENERAL

All calculations and computations will be on a market value basis, as recorded by the System's custodian.

This Policy contains a Glossary of Terms in Section VIII. of this document.

VIII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms are referenced in the System's Master Glossary of Terms.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
FRANCHISE FINANCE REAL ESTATE

November 13, 2000

This Policy is effective immediately upon adoption and supersedes all previous franchise finance real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Franchise Finance Real Estate Portfolio (collectively referred to as "the Portfolio"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with franchise finance investments.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return possible consistent with a prudent level of risk and the liabilities of the System and the investment guidelines contained herein is the strategic objective of this Policy. This Portfolio shall be considered a component of the Specialized Equity Real Estate Portfolio, and as such, shall be required to achieve an appropriate risk-adjusted return. The Portfolio shall be managed to assist the System in achieving its long-term objective of exceeding a minimum target real rate of return of 6.0% (after fees). The Portfolio shall be expected to achieve a real rate of return consistent with other equity real estate investments of similar risk.

The Portfolio shall be subject to the investment processes described in the Statement of Objectives and Policies for the Equity Real Estate Portfolio and the Delegations of Authority incorporated herein by reference hereto. Investment in franchise finance shall be undertaken only if consistent with the System's objectives of capital preservation, diversification of risk, and achievement of real rates of return.

The Portfolio shall be managed to accomplish the following:

A. Preserve investment capital;

B. Generate attractive risk-adjusted rates of return for the System as a total return investor;

C. Provide a source of cash flow;

D. Provide a hedge against inflation; and

E. Consider solely the interest of the System's participants and beneficiaries in accordance with California State Law.

III. INVESTMENT APPROACHES AND PARAMETERS

A. Risks

1. Several unique risks are associated with investments in franchise finance, which include the following:

   a. Franchised restaurant buildings are special purpose facilities. Although it may be possible to reuse the buildings for other purposes, the cost of retrofitting may be expensive or prohibitive;

   b. Each unit has a single tenant, which means that in the event of tenant default, the entire property produces no income; and

   c. The restaurant industry is cyclical and has some systematic risk.

2. Some of these disadvantages are mitigated, by the following considerations:

   a. Many franchised restaurant buildings can be reused efficiently for other restaurant operations;

   b. The default rate on high-grade franchised restaurants is low; and

   c. The franchise finance investment structure provides an attractive combination of base return (rent), as well as a participation in gross sales, thereby allowing the income stream to keep pace with, or even exceed, inflation levels.

B. Diversification

The Portfolio should be well diversified to minimize risks due to overexposure to any one risk factor (e.g., region, concept, segment, and operator). The Portfolio should be diversified along the following criteria:

1. Geographical location;
2. Franchiser/franchised chain company;
3. Franchisee/operator of the restaurant unit(s);
4. Concept/type (hamburgers vs. fish, or hamburgers vs. ethnic, and so forth); and
5. Market segment (targeted segment of the restaurant market as defined by the price of the average meal).

C. Size

1. Investments in commingled funds shall not exceed 25% of any one Fund; and
2. Investment transaction size shall be limited to transactions that include a minimum of $5 million. Typically, franchise finance transactions range in size from three to five units (e.g., restaurants), at an average value of $750,000 to $850,000 per unit.

D. Structure

1. The System may invest in any one or any combination of the following structural components of franchise finance, with the exception that investments made solely in trade equipment are not preferred:
   a. Land on which the property is situated;
   b. Building improvements; and
   c. Trade equipment necessary for operations.
2. The System may structure investments in the following manner:
   a. All three elements can be owned by the investor and leased to the operator;
   b. All three elements can be owned by the operator and mortgaged to the investor; or

c. In some cases, a portion of the investment can be in the form of an owner/lessee relationship, while another portion is in the form of a lender/borrower relationship.

3. The System shall evaluate opportunities in the context of their individual risk and reward characteristics.

4. The preferred form of financial structure for the System is an opportunity that includes some form of base rent increased periodically plus income participation at the individual unit (restaurant) level. Other structures shall be considered on an individual basis.

E. Vehicles

1. The System may invest in either a direct investment or an indirect commingled fund, as appropriate, depending upon the nature of the investment. The advantages and disadvantages of each structure shall be considered by the System when selecting the appropriate vehicle.

2. Generally, commingled funds shall be utilized when their diversification benefits are most desirable, while direct investments shall be utilized when closer control over the investment, at a lower fee structure, is the primary concern.

3. Direct investments shall be the preferred vehicle for portfolios of units that minimize the need for diversification by virtue of their strength in the marketplace and stronger credit characteristics. Such portfolios include investments in existing properties, with relatively large franchisers, operated by franchisees with a relatively large number of units dominant in their market, and when the transaction size is relatively large.

4. Commingled funds shall be generally more appropriate for smaller, less established franchises, with smaller, less established operators, as well as a smaller transaction size. Investments in speculative development opportunities shall be generally made through a commingled fund and have a relatively high return expectation.

5. To ensure adequate diversification, the System shall consider only those investment vehicles that include numerous individual properties.

6. To ensure appropriate portfolio diversification, the System shall consider the timing, prioritization, and characteristics of each investment.

F. Selection of Management Firms

1. The System shall invest in real estate franchise finance on a direct or indirect basis through third-party investment advisors, general partners, operating company management teams or other organizations with specific expertise in specialized real estate investments (collectively referred to as "Management Firms"). Management Firms shall provide expertise and experience in locating, negotiating, monitoring, and disposing of franchise finance investments. The System shall establish and document specific, relevant selection criteria for each Management Firm prior to selection to establish the basis on which the selection shall be made. The System shall approve Management Firms based on their successful history or significant potential in managing and implementing specialized real estate investment programs, and their reputation.

2. Selection of Management Firms is critical to the success of the Program due to the non-traditional, highly specialized nature of franchise finance. Management Firms selected by the System shall have investment and asset management discretion, with oversight and periodic review by the System.

3. Management Firms shall represent only the interests of the System in these transactions or only the interests of the investor group if the System co-invests with another client or other clients of the advisors.

G. Investment Criteria

The System shall direct its investments to franchise finance properties and portfolios with the characteristics listed as follows in paragraphs one through five. Strict adherence to these guidelines is not mandated but, rather, transactions that do not conform to the guidelines are subject to additional review.

1. Property Life Cycle - To ensure restaurant success, the System shall generally invest in existing franchise restaurants at already established locations or in those that meet other demographic criteria.

2. Franchiser - The System shall limit investments to those franchises that represent recognized national franchises or very strong regional franchises. Acknowledging that any specific threshold is somewhat arbitrary, the System shall generally limit investments to restaurant franchisers with gross system sales in excess of $500 million (in 1999 dollars). This threshold includes approximately 25 to 30 franchisers at present. In addition to strong chain-wide sales, franchisers should also have strong average unit sales.

3. Market Position - The System shall limit investment to units affiliated with franchises that have a major presence in the specific market area in which the investment is contemplated. Generally, franchisers should be the first or second largest franchise within a specific restaurant concept. Thus, the System shall not invest in a unit that represents, for example, the fourth largest “fish” concept in its market, regardless of the national sales volume for the franchiser. Some concepts such as “hamburger,” however, are deeper and, in such instances, may merit an investment in the third or even fourth largest franchise.

4. Operator/Franchisee - Generally, the System shall limit investment to operators with 10 or more units under management. This limitation shall help ensure that experienced franchisees operate the System’s investments. All operators should be experienced with solid net worth and proven operational skills.

5. Property Sites - Properties shall be located along major thoroughfares, near employment centers, or within established retail districts with convenient access and good visibility. Locations should demonstrate demographic strength, economic viability, site utility, adequate size, and community acceptance.

H. Asset Management

The System’s advisors and Management Firms responsible for the Portfolio shall represent the System’s interest in asset management decisions, providing daily property management services, as expertise and organizational structure allow. The System shall give Management Firms the appropriate delegation of authority along with requiring appropriate measures of accountability. Advisors and Management Firms shall represent only the System’s interests in these transactions or only the interests of the investor group if the System co-invests with other clients in such transactions.

All relevant financial and operational controls, as well as reporting requirements applied to other equity real estate investments, may be modified to reflect the specific asset management requirements of the Portfolio.

IV. GENERAL

A. Members of the System developed this Policy primarily with respect to restaurant franchises. Though the more general precepts and guidelines embodied in this Policy remain valid regardless of the specific underlying industry, the System recognizes that some of the more specific guidelines may need to be revised in the context of investments in underlying industries other than restaurants, should such opportunities arise.

Franchise finance is considered a Specialized Real Estate Investment as it offers the opportunity for the System to diversify its Equity Real Estate Portfolio, and thereby helps to minimize overall portfolio risk by investing in a property type other than Core. An investment in franchise finance is essentially an investment in the restaurant industry; the performance of the investment relates directly to the success of the franchised restaurant's operations due to a portion of the lease income being a percentage of restaurant sales.

B. This Policy contains a Glossary of Terms in Section VII of this document.

V. ASSET ALLOCATION

Allocations to the Portfolio shall be consistent with allocation parameters for Core and Specialized Real Estate Investments in the Statement of Investment Policies, Guidelines, and Procedures for the Equity Real Estate Portfolio. As a percent of the total allocated Specialized Real Estate Portfolio, this Portfolio in aggregate with other Alternative Strategies[1] as further defined in the Specialized Policy, shall range from 0 to 30%.

From time to time, the actual investment may fall out of the allocation ranges prescribed by the Policy. In these instances, adjustments to correct the actual to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

VI. VALUATION

Unless otherwise noted, investors, managers, consultants, or other participants selected by the System shall base all calculations and computations on fair market value. Market value, as used in such calculations, is defined by the

[1] Alternative Strategies to include opportunistic investment, Hotels, Franchise Finance, and Mezzanine Debt Investment Programs.

Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation and shall be incorporated when reporting fair market value for accounting purposes.

VII. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the CalPERS Master Glossary of Terms.

Franchiser - The owner of a trademark, trade name, or copyright authorizes others, under certain conditions, to use it in purveying goods or services.

Market Position - The strength of sales of the market concept as it relates to a particular market and its demographics.

Operator/Franchisee - The party authorized by the owner of the trademark, trade name or copyright to purvey goods or services.

Property Life Cycle - The cycle of business in which a restaurant or other business experiences (i.e. newly opened, established, failing, failed).

Property Sites - The location of a property and its physical characteristics.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY
FOR
HAZARDOUS MATERIALS IN REAL ESTATE INVESTMENTS

August 19, 2002

This Policy is effective immediately upon adoption and supersedes all previous real estate hazardous materials policies.

I. PURPOSE

This document sets forth the investment policy ("this Policy") for property contaminated by hazardous materials in the real estate investment program ("the Program"). This Policy will require investment managers, advisors, partners and other participants (the foregoing are referred to in this Policy collectively as the "investment manager") selected by the California Public Employees' Retirement System ("the System") to take prudent action with respect to hazardous materials, consistent with their fiduciary duties to the System and in compliance with environmental laws, in the execution of the Program. This Policy allows reasonable flexibility in assessing and mitigating environmental risks to capture investment opportunities for the Program.

II. STRATEGIC OBJECTIVE

The strategic objective of this Policy is to minimize liability under environmental laws that may be incurred by the System through the Program.

III. ENVIRONMENTAL LAWS

This Policy is necessary because the costs of clean-up and other liabilities created by environmental laws in purchasing, leasing or disposing of, or making a loan secured by, real property contaminated by hazardous materials may have a significant effect on the investment return to the System. Liability for environmental contamination is a dynamic legal field that has expanded rapidly and continues to change. The investment manager needs to be aware of significant developments in the law as they occur. The landmark federal environmental law known as "Superfund" or "CERCLA" (Comprehensive Environmental Response, Compensation and Liability Act) imposes liability on owners of real property contaminated by hazardous materials, regardless of whether the current owner was responsible for the initial contamination. Under CERCLA, an owner may, however, avoid liability if the owner undertook "all appropriate inquiries" into the previous ownership, uses and condition of the property. Most states have also enacted statutes imposing liability for hazardous materials contamination (see, e.g., California Health and Safety Code Sections 25300, et seq.), and all states have traditional tort law doctrines that may apply to real property contamination. State law may also require an owner who knows (or should know) that the property is contaminated by hazardous materials to give written notice of the contamination to a tenant or a buyer of the real property, and the owner may be liable to a tenant or a buyer for any failure to disclose the contamination (see, e.g., California Health and Safety Code Section 25359.7).

New laws are created to address the potential adverse human health effects of environmental conditions associated with the use of real property. For example, legal standards have begun to emerge with respect to the presence of molds which may be hazardous to human health (see, e.g., New York City Department of Health, Guidelines on Assessment and Remediation of Fungi in Indoor Environments (November 2000); and U.S. Environmental Protection Agency, Mold Remediation in Schools and Commercial Buildings (March 2001)). California's Mold Protection Act of 2001 imposes an immediate duty on commercial and industrial landlords, who have notice of the presence of mold or water intrusion, both to assess the presence of mold (or conditions likely to cause it) and to conduct necessary remedial action. Some of the hazardous materials that may contaminate real property and create liability for an owner or a lender are described in Section VI of this Policy.

IV. ACQUISITIONS, FINANCINGS AND DISPOSITIONS

The guidelines in this Section apply to all acquisitions and dispositions of real property made by the System directly or through co-investment ventures with partners and to all loans held by the System directly or through participation arrangements in which the System has an interest in the real property (which excludes investments in securities supported by mortgage pools).

A. Acquisitions and New Loans

1. To minimize the risk of loss and the potential liability that the System might incur, the System shall not make acquisitions of, or loans secured by, real property contaminated by hazardous materials except as set forth in this Section.

2. Before each acquisition or loan, the investment manager shall appropriately investigate potential hazardous materials contamination in a "due diligence" review of the real property. The purpose of the investigation will be to assess environmental risk and, if it exists, to determine whether appropriate environmental risk mitigation measures are available to address it.

3. The results of the investigation shall be contained in a written report.

a. In general, the investigation and report should include a "Phase I Environmental Site Assessment" conducted by a qualified consultant(s) experienced in hazardous materials inspections and surveys, which complies with the standards for "all appropriate inquiries" established pursuant to CERCLA. The report should include the following information:

(1) The results of an inquiry into the identity of previous owners and tenants and the nature of prior and existing uses of the real property to identify the potential for contamination on or about the real property;

(2) Commonly known or reasonably ascertainable information about the obvious or likely presence of contamination on or about the real property; and

(3) A summary of all publicly available governmental records and reports (including building records) with respect to the environmental condition of the real property.

b. The investment manager may determine, based on the report, considering the character of the property, and taking into account the advice and recommendations of the consultant(s), that the scope of the investigation should be expanded, which may include the following tests for hazardous materials:

(1) Building air quality sampling and analysis;

(2) Sampling and analysis of building materials for the presence of asbestos and other hazardous materials (specifying, if asbestos or other hazardous materials are found, the identification of the building and the area within the building containing asbestos or other hazardous materials, and whether efforts have been made to remediate the asbestos or other hazardous materials);

(3) Surface and subsurface soil tests;

(4) Surface water and groundwater quality tests; and

(5) Sampling and analysis of building materials, occupied spaces, HVAC systems, and indoor air for infestation of molds, other fungi or bacteria, or other microorganisms that may pose a risk of adverse effects on human health (specifying, if infestation is found, the location, extent and magnitude, the source

or contributing conditions, the foreseeable growth if unremediated, and whether remediation efforts have been made).

4. Real property that is found to be contaminated by asbestos, molds or other hazardous materials may be acquired or used as security for a loan when the investment manager concludes, in the exercise of reasonable judgment consistent with good industry practices and based on the advice and recommendations of the consultant(s) and, if appropriate, advice of staff and legal counsel, that (a) mitigation measures are already in place or can be implemented by the investment manager to effectively mitigate the risks to the System and (b) with such measures, the real property will yield an appropriate risk-adjusted rate of return to the System. The mitigation measures could include removal of the hazardous materials; a “no further action” or “closure” letter or a covenant not to sue (such as a “Prospective Purchaser Agreement”) from the pertinent government agency; an indemnity or undertaking from a financially responsible party who has assumed responsibility for the contamination; environmental insurance covering the risk of loss; or a comparable mechanism that mitigates environmental liabilities associated with the hazardous materials or permits residual contamination to remain on the property without further corrective action. The investment manager will be responsible for implementation of the required mitigation.

5. To the extent it is feasible under the circumstances of the investment, the seller or borrower should (a) represent and warrant that the real property is not contaminated by hazardous materials and does not violate any environmental laws and (b) indemnify the System against and hold the System harmless from any damage or liability from environmental contamination.

B. Existing Loans

1. Refinance or Extension of Loan

a. No existing loan shall be refinanced or extended unless the investment manager has completed the investigation required for acquisitions and new loans in accordance with Section IV.A.3 of this Policy to determine whether hazardous materials are present on the real property.

b. An existing loan shall not be refinanced or extended if hazardous materials are present on the real property security for the loan, unless the investment manager either concludes that mitigation measures are already in place or can be carried out in accordance with Section IV.A.4 of this Policy or determines, taking into account the results of the investigation and advice of staff, legal counsel and consultants, that:

(1) the refinancing or extension will substantially decrease the potential risk of loss and liability that will be incurred by the System in the event that the borrower cannot obtain other financing and defaults on the loan, and

(2) the refinancing or extension will enable the borrower to remove or effectively mitigate the effects of the contamination.

If it is concluded that such a loan should be refinanced or extended, a condition to such refinancing or extension shall be that the borrower undertake to remove or effectively mitigate the effects of the contamination as described in Section IV.A.4 of this Policy.

2. Default on Existing Loan

a. Upon default under an existing loan secured by real property, reasonable efforts shall be made to induce the borrower to cure the default. If the borrower fails to cure the default, the investment manager shall complete the investigation required to be prepared for acquisitions and new loans in accordance with Section IV.A.3 of this Policy to determine whether hazardous materials are present on the real property.

b. If, after such investigation, it is determined either that hazardous materials are not present or that mitigation measures are already in place or can be carried out by the System after acquisition of the real property in accordance with Section IV.A.4 of this Policy, then normal actions to collect the debt and enforce the System's rights in its security may be undertaken.

c. If such investigation indicates that the real property security is contaminated by hazardous materials, an analysis shall be made of the potential risk of loss and liability that will be incurred by the System if it acquires ownership of the real property security through foreclosure. The System shall complete a foreclosure and acquisition of such real property only if such analysis indicates that the risk of loss and potential liability is acceptable in relation to the size of the debt and the probable recovery of the investment by the System.

C. Dispositions

1. When the decision to sell real property has been made, the investment manager shall become familiar with the environmental condition of the real property. In some cases (e.g., where the real property may have been contaminated by hazardous materials after the acquisition by the System or the co-investment venture), it may be prudent to conduct a baseline environmental assessment, similar to the investigation described in Section IV.A.3 of this Policy, to establish the existence or level of contamination at the time of the sale.

2. In all cases, the investment manager shall (a) take into account any environmental liability issues in selling the real property, (b) make all disclosures to the buyer required by law, and (c) use reasonable efforts to minimize the post-closing liability of the System or the co-investment venture by, to the extent feasible, disclaiming any representations or warranties concerning environmental contamination of the real property, avoiding any indemnification of the buyer for environmental liabilities, and selling the real property on an “as is” basis.

V. ASSET MANAGEMENT

The investment manager responsible for the management of real property in the Program shall implement reasonable measures to ensure that the System’s investments are operated and maintained in ongoing compliance with legal obligations related to hazardous materials. These measures may include the following, as appropriate for each asset, on a continuing basis:

A. Collect and analyze information:

1. Environmental reports, including any investigation pursuant to Section IV.A.3 of this Policy.

2. Tenant information, including pre-leasing questionnaires.

3. Information obtained during physical inspections of the site.

4. Information developed in response to environmental incidents on the site.

B. Comply with regulatory requirements:

1. Timely issuance and renewal of environmental permits.

2. Timely submission of required information disclosures.

3. Periodic monitoring of tenants' activities and environmental compliance.

4. Prompt follow-up on identified noncompliance issues.

C. Manage environmental conditions:

1. Appropriate training of management personnel in environmental emergency response procedures, including reporting requirements.

2. Inclusion of environmental factors (e.g., inspections of storage tanks, asbestos-containing materials, and mold conditions) in routine maintenance and repairs.

3. Inspection of tenants' premises, and identification and remediation of adverse environmental conditions, prior to lease termination.

VI. HAZARDOUS MATERIALS GLOSSARY

Some of the common hazardous materials that may contaminate real property and create liability for the owner are listed below. This list is not exhaustive. Other substances may be of equal or greater concern.

<u>Molds, fungi, bacteria and other microorganisms.</u>

Molds are forms of fungi that live on plant or animal matter and in indoor environments, frequently in water-damaged building materials such as gypsum wallboard, carpeting, wood and ceiling tiles. Molds thus can be found in residential, commercial or industrial structures. Potential sources of moisture that can lead to mold infestation include leaking pipes, flood damage, leaking windows and roofs, HVAC leakage, sewage backup, and inadequate ventilation.

<u>Asbestos.</u>

Asbestos is a mineral which formerly was widely used in building construction, particularly in insulation, roofing felts, fire-resistant drywall, and acoustical products.

<u>Lead.</u>

Lead-based paint, and drinking water contaminated by lead-containing pipes or fixtures, are the most common sources of lead exposure.

<u>Polychlorinated biphenyls (PCBs).</u>

PCBs formerly were widely used as insulating fluids in electrical transformers and capacitors, and in fluorescent light ballasts.

Radon.

Radon gas, a decay product of radium, is found as a natural component of rock and soils.

Petroleum compounds and chemicals in storage tanks.

Both aboveground and underground storage tanks are widely used at residential, commercial and industrial sites for storing fuels, chemical raw materials, pesticides or lawn care products, waste oils, and other hazardous substances and wastes.

To the extent the investment manager believes it is appropriate to do so, the investigation required by Section IV.A.3 of this Policy should include the foregoing hazardous materials.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
INTERNATIONAL EQUITY REAL ESTATE

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous international real estate policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the International Equity Real Estate Investment Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with international equity real estate investment.

II. STRATEGIC OBJECTIVE

Generating superior risk-adjusted returns compared to the System's Direct Core Equity Real Estate Portfolio is the overriding objective of the Program. The investment selection shall be oriented to achieve the objectives of preservation of capital and diversification of risk. "International" is defined as being any geographic location other than the eight domestic - U.S. NCREIF (National Council of Real Estate Investment Fiduciaries) regions and the territory of Puerto Rico. The System shall make such investments under specified conditions and circumstances as described in this statement. The System's ability to commit large amounts of capital and long-term investment horizon give it a distinct advantage in investing in international real estate investments.

The expected rates of return shall be related to the countries selected for investment and their relative stages of development, targeted property types, relative control or liquidity or both that are associated with the real estate investment, and other structuring techniques used to mitigate taxes, if any.

III. PERFORMANCE OBJECTIVE

The performance of the Portfolio shall be compared to its stated benchmarks, and target returns in excess of the minimum 5% overall real return objective for the U.S. Core Equity Real Estate Portfolio.

IV. INVESTMENT APPROACHES AND PARAMETERS

A. **Risks**

The following factors shall be considered in assessing the attractiveness of international investing:

1. The tax treatment for the System by country and its potential impact on total return;

2. The difficulty in obtaining information regarding the behavior of private international real estate markets, and benchmarking performance;

3. Significant variance in risk and return attributes of real estate in developed countries compared with those associated with markets in developing countries; and

4. The use of leverage to minimize the tax burden often associated with international real estate investments and the direct impact this leverage has on the risk and required return of such investments.

There are unique risks associated with investment in international real estate. The primary ones are as follows:

1. The legal and regulatory environment;

2. Potential political and economic instability;

3. Currency exchange rate volatility;

4. Inconsistent building design and construction standards;

5. Tax policy and regulatory differences; and

6. Lack of reliable and consistent real estate market information and local employment and demographic data.

The mitigation of risks shall be achieved through techniques such as, but not limited to, the following:

1. Careful underwriting;

2. Legal and tax review; and

3. Retention of qualified experts familiar with the markets under consideration.

B. **Diversification Guidelines**

Given the specialized nature of international equity real estate investments, and the stated overall objective, it is not possible to mandate strict diversification guidelines for these investments. Capital allocations shall be primarily driven by market opportunities. The System shall seek to maintain a prudent level of diversification within and among such investments.

When investing in international real estate, prudent review and due diligence shall include review of political, economic, and social risks, as well as expropriation probabilities associated with the respective countries. In instances such as international commingled funds where the System may not have control over the investments, Staff will closely monitor such funds and report to the Investment Committee when such investments are at risk.

Care shall be given to avoid undue concentrations in developed or developing countries, or in any one particular country, region, or property type.

In those instances where investments are being considered in Emerging Markets, the Senior Investment Officer, (SIO), Real Estate shall have the discretion to permit real estate investments in emerging countries that obtain a favorable score, as approved by the Investment Committee, on the Wilshire Permissible Equity Market List with the exception of the capital market factors, as updated and reviewed annually. Emerging countries that do not score favorably on the Wilshire Permissible Equity Market List, but demonstrate compelling investment rationale will require Investment Committee approval. Emerging countries that are not reviewed in conjunction with the Wilshire Consulting Permissible Equity Market List, and are deemed to have sufficient investment merits, will require Investment Committee approval. Recognizing the ability of emerging countries to fall on and off the Permissible Equity Market List, investments will be approved for real estate investment according to the list in effect at the time of the proposed investment.

C. **Investment Size**

The size of international real estate investments shall depend on the opportunities available to the System, with neither small nor large investments dominating the Portfolio. Additionally, investment size shall be appropriate to the projected risk/return level of the investments. However, in order to have some composite effect on the Portfolio, preference shall be given to investments with funding commitments of $50 million or greater in size.

D. **Structures**

The Program shall be implemented through direct equity investments in international real estate (either 100% owned or through commingled vehicles), or through publicly traded international real estate securities, or some combination thereof. Equity, leveraged equity, and hybrid investment structures are available for direct investment in international real estate by the System.

E. **Vehicles**

The System shall consider a number of investment vehicles for investing internationally in real estate, including, but not limited to, the following:

1. Direct real estate equity investments in 100% owned assets;

2. Real estate equity joint ventures or other co-investment vehicles for real estate;

3. Indirect private real estate equity investments in commingled funds, private Real Estate Investment Trusts (REITs), limited partnerships, or other pooled investment vehicles;

4. Purchase of controlling or non-controlling interests of public or private international real estate operating companies;

In choosing specific investment vehicles for international real estate, the System shall consider, but not limit its options to, the following:

1. Proposed investment strategy;

2. Expected risk and return attributes of vehicles;

3. Potential exit strategies and liquidity;

4. Appropriate levels of control;

5. Monitoring costs and feasibility;

6. Potential diversification benefits;

7. Tax considerations;

8. Other incremental costs;

9. Governance and control of structure; and

10. Partners or co-investors.

F. **Selection of Investment Management Firms**

The System shall invest in international real estate investments on a direct or indirect basis through third-party investment advisors, general partners, operating company management teams, or other organizations with specific expertise in international real estate investments (collectively referred to as "Management Firms"). Management Firms shall provide expertise and experience locating, negotiating the acquisition, monitoring, and disposing of international real estate investments. Before selection, the System shall establish and document specific relevant criteria for each Management Firm to establish the basis upon which to make the selection.

Selection of management is critical to the success of the International Real Estate Program. The System shall approve Management Firms based on their specific, successful and significant expertise (including the ability to mitigate risks identified in these markets) in locating, negotiating the acquisition, monitoring, and disposing of international real estate investments, in the particular, specific real estate market. Management Firms shall act in a fiduciary capacity and represent only the interests of the System in these transactions or, if the System is a co-investor, only the interests of the investor or shareholder group.

G. **Asset Management**

Management Firms shall represent the System's interests in asset management decisions, providing daily property management services, as expertise and organizational structure allow. The System shall give Management Firms appropriate Delegation of Authority while requiring that they provide adequate measures of accountability.

Appropriate financial and operational controls, as well as reporting requirements applied to direct domestic equity real estate investment, shall also apply to direct international real estate investment, to the extent consistent with the investment practices of local jurisdictions where appropriate. This shall include audited financial statements on a basis consistent with the System's accounting policy where appropriate. U.S.-dollar denominated accounting and performance information shall be required.

V. BENCHMARK

The performance of the Portfolio shall be compared to U.S. equity real estate benchmarks, the NCREIF and WRESI indices, and stated performance objectives. Where feasible, customized benchmarks shall also be developed for these investments (taking into account their specific risk attributes such as those described in Section IV, Investment Approaches and Parameters).

VI. GENERAL

This Policy is intended for investment in direct equity real estate that includes property types such as, but not limited to, the following: office, retail, apartment, industrial, hotel, and resort properties. International real estate securities shall also be included as potential investments. International real estate investments shall be classified as a "specialized" real estate investment sector.

This Policy contains a Glossary of Terms in Section VIII of this document.

VII. ASSET ALLOCATION

As a percent of the total allocated Specialized Real Estate Portfolio, the international real estate sector shall range from 0 to 15%.

From time to time, the actual investment may fall out of the ranges prescribed by Policy. In these instances, adjustments to correct the actual to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment to the System.

VIII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms are referenced in the System's Master Glossary of Terms.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
REAL ESTATE DEVELOPMENT

August 12, 1998

This Policy is effective immediately upon adoption and supersedes all previous real estate development policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for Real Estate Development ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in the management process to capture investment opportunities in this segment of the market.

II. STRATEGIC OBJECTIVE

Realizing attractive risk-adjusted returns is the strategic objective of the Program. Investors, managers, consultants, or other participants selected by the System targeting the real rate of return shall consider the stage in the development life cycle. The earlier in the development process, the greater the return expectation. Investments in real estate development shall target risk-adjusted returns higher than those of existing core real estate investments.

III. GENERAL

The amount of development undertaken shall be subject to investment guidelines as described in the individual policies adopted for apartments, industrial, office, and retail real estate investments. The Statement of Investment Objectives and Policies for Real Estate Equity Joint Ventures and the Statement of Investment Objectives and Policies for the Equity Real Estate Portfolio give additional guidance concerning development. Development activity shall be allowed in both Core and Specialized Portfolios. Both Portfolios are subject to policies specific to Core portfolio investing, limiting the amount of development allowed in each portfolio. The applicable property type policy and this Policy shall govern real estate investments.

The System shall generally invest in a development project only under the following circumstance. If entitlements are not obtained, the entitlement process should be free of private and governmental restrictions upon the intended development. Such restrictions include, but are not limited to, no-growth initiatives, building moratoriums, and conflicts with general plan amendments. Developments shall reasonably be expected to receive site plan approval in the ordinary course of business.

Parties suggesting investments in development projects other than those described above shall make a presentation to the System for their specific approval. Investments in the Single-Family Housing and Acquisition and Development Programs do not fall under this Policy.

IV. INVESTMENT VEHICLES

The System shall invest in development projects on a joint venture basis with development partners. Additionally, the System shall invest through investment advisors, both on a separate account basis and on a commingled fund basis. Investment advisors shall provide expertise in negotiating and monitoring development agreements.

V. SELECTION OF DEVELOPMENT PARTNERS

Development activities shall focus on strategic partnerships with quality developers. The investment manager shall control design, amenities, cost, and overall quality of construction projects. The System recognizes that the selection of a development partner is critical to the success of development project and for avoiding disputes that cost time and effort in their resolution.

Potential development partners shall be evaluated on past development and property management experience with projects of similar size and type in the specified geographic market. Additional evaluation factors include financial depth, liquidity, stability, and capital commitment to the project. Project personnel must demonstrate their experience and ability to perform all development related tasks, from construction management to leasing for projects of similar size and type in the specified market, and commitment to the company and project. Development partners must also have a long-term investment objective consistent with the System's. A previous successful working relationship with the investment advisor shall be viewed favorably. A potential partner's credentials, credit, professional references, and financial statements shall be evaluated prior to accepting a development proposal.

Generally, the System shall align interests of developers with itself and the development partners through capital contribution. For example, in the form of a letter of credit covering a cost overrun guarantee or imputed capital such as land at risk in the development.

VI. SELECTION OF ADVISOR

The System recognizes that the selection of a development advisor is critical for the success of a development project. The System shall approve investment advisors based on their successful history in negotiating and monitoring development investments. Potential development advisors shall be evaluated on their development and asset management capabilities. Evaluations shall include engineering and financial analysis, advisors' significant experience in monitoring or asset management of development investments or both, and thorough understanding of the issues involved in negotiating and making development investments. Advisors shall demonstrate their ability to successfully negotiate development agreements, experience in resolving disputes arising in development investments, and reliable track record in working with established developers. A potential development advisor's credentials, references, and financial statements shall be reviewed before selecting an advisor.

VII. MARKET AND DEVELOPMENT SELECTION CRITERIA

The System recognizes that market selection is critical to the success of a development project. The analysis includes consideration of socioeconomic, market, and neighborhood characteristics. Specific attention shall be directed toward current and future vacancy rates, which are based upon supply planned and under construction, regulatory controls, and employment growth.

In addition to market, property life cycle, and property type development guidelines, the analysis of potential development investments shall also be based on the physical and economic characteristics described in detail in the Investment Objectives and Criteria sections of the System's Statement of Core Apartment, Office, Industrial, and Retail Investment Policies.

Physical attributes considered shall include the site, property, size, exterior and interior characteristics, building services and amenities. Economic standards encompass analysis of the income and expense potential that will determine future cash flow and value enhancement.

VIII. INVESTMENT STRUCTURE

Development investment structures are not standard, but they are determined by the terms negotiated in the transaction. Therefore, investment advisors shall remain flexible in negotiating such agreements. In general, advisors shall maximize the potential for success in joint ventures by minimizing the creation of divergent interests among partners. As a rule, negotiated agreements shall be precise in the following areas:

A. **Equity joint ventures**

For all equity joint ventures, the advisors shall follow these guidelines:

1. Ownership: Ownership shall be subject to the Ownership and Developer Investment Share Guidelines presented in the Statement of Objectives and Policies for Equity Real Estate Joint Ventures.

2. Leverage: Leverage shall be subject to the guidelines presented in the Statement of Objectives and Policies for Real Estate Leverage.

3. Distribution to Partners: Distributions shall be subject to the guidelines presented in the Statement of Objectives and Policies for Equity Real Estate Joint Ventures. The System requires a cumulative preferred return and a minimum 50% share of proceeds once the cumulative preferred return has been met from property cash flow and sale or refinancing or both.

   The development partner's return may include participation in cash flow and sale, or refinancing proceeds and incentive participation, based on meeting or exceeding pro forma or budget thresholds. The System shall negotiate the preferred return and share of proceeds distributed to each partner, taking into consideration the relative risk each party is assuming. Additional negotiation factors include the share of total capital contributed by each partner, the current market terms for similar joint ventures, and the value enhancement and risk management elements for that development project contributed by each partner. The timing of the distribution to the developer may be based on meeting break-even point leasing requirements or completion or both and occupancy of phased construction projects.

4. Contributions: Contributions shall be subject to the guidelines presented in the Statement of Objectives and Policies for Equity Real Estate Joint Ventures. The System

shall require, at a minimum, that the developer commit capital or risk capital (for example, through a letter of credit covering a cost overrun guarantee). The System shall recognize the imputed value of land with zoning, entitlement, and building permit approvals as an additional equity contribution by the developer partner.

5. Responsibility of Partners: A Development Services Agreement shall clearly identify the responsibilities of partners. The development partners' responsibilities shall included pre-development phase services such as initial planning, schematic design, design development, working drawings, contractor bidding, and selection. Development Phase services shall include construction management and administration. Development Phase reporting by the development manager shall include monthly reports regarding the construction status, budget-to-actual comparison for the project to that date, a summary of change orders in the month covered by the report, and any changes to the budget or schedule of the project.

6. Resolution of Disputes: Resolution of disputes shall be subject to the guidelines presented in the Statement of Objectives and Policies for Equity Joint Ventures. If a development partner fails to perform under the terms and conditions of the agreement with the System, it may replace them.

7. Transfer of Interests: Transfer of interests shall be subject to the guidelines presented in the Statement of Objectives and Policies for Equity Real Estate Joint Ventures.

B. **Construction**

The System shall seek to mitigate construction risk, for example, through the use of maximum price guarantees, payment bonds, or completion bonds (also known as performance bonds), where appropriate. Development ventures that involve construction risk shall follow these guidelines:

1. Construction Cost Overruns: Construction cost overruns shall be subject to the guidelines presented in the Statement of Objectives and Policies for Equity Real Estate Joint Ventures.

2. Cost Verification Procedures: The development advisor's engineering and construction staff, on behalf of the System, shall conduct the following procedures:

   a. Review and approve the construction budget;

   b. Review and approve plans and specifications;

   c. Reconcile construction bids to budget;

   d. Give authority to commence construction; and

   e. Prepare a monthly engineering inspection report.

   If invoices meet engineering inspection reports, the investment advisor shall make disbursements on a monthly basis.

IX. ASSET AND PROPERTY MANAGEMENT

Asset management is subject to the guidelines presented in the Statement of Objectives and Policies for Equity Real Estate Joint Ventures. The developer or a fee manager selected by the developer shall provide property management services.

X. FEES

Advisor fees for development projects are subject to the guidelines presented in the Statement of Objectives and Policies for Equity Real Estate Joint Ventures. The System recognizes that additional risk may be involved in monitoring equity joint venture agreements and projects, specifically during the construction and development phases. Therefore, the System reserves the right to have advisors bid a different fee schedule for these services.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
REAL ESTATE HYBRID DEBT INVESTMENTS

August 12, 1998

This Policy is effective immediately upon adoption and supersedes all previous real estate hybrid debt investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Real Estate Hybrid Debt Investments ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in the management process for capturing investment opportunities.

Real estate hybrid debt investments shall be subject to investment processes as described in the Statement of Investment Objectives and Policies for the Equity Real Estate Portfolio and the Delegation and Approval Guidelines.

II. STRATEGIC OBJECTIVE

Diversifying the equity real estate portfolio is the strategic objective of the Program. The System shall make such investments under the specified conditions and circumstances as described in this Policy.

Real estate hybrid debt investments allow the System to maintain the safety of its invested principal and potentially earn higher returns than through conventional mortgages. These investments allow the System to invest in properties that might not otherwise be available. In the case of convertible mortgages, the System can observe property performance prior to investment.

Real estate hybrid debt investments shall achieve a long-term real rate of return consistent with the overall objective of the Equity Real Estate Portfolio. The returns shall be greater than those available from conventional mortgages but are expected to be less than those from all other equity investments. Investment selection shall preserve capital and achieve real rates of return.

III. INVESTMENT APPROACHES AND PARAMETERS

A. Investment Size

Real estate hybrid debt investment size should be measured by the amount of capital invested. Neither small nor large investments shall dominate the portfolio. Investment size should be in a range similar to other investments as set forth in the Statement of Objectives and Policies for the Equity Real Estate Portfolio.

B. Property Life Cycle

The System may invest in real estate hybrid debt investments comprised of existing and developmental projects. For development projects, funding shall occur when the property receives a certificate of occupancy and the occupancy percent meets the predefined minimum for the property.

For existing and development projects, forward commitments to fund the loan upon achievement of certain requirements may be made for no more than three years in the future. In cases where a property meets the minimum percentage leased requirements, but does not yet generate cash flow sufficient to cover debt service, the commitment amount may contain a debt service coverage reserve or a holdback reserve. The coverage or holdback reserve is for tenant improvement and leasing cost disbursements as needed during a lease-up period of no more than two years. Alternatively, the borrower may provide a letter of credit or appropriate income guarantees to cover the intervening lease-up period.

C. Property Types

The System shall consider real estate hybrid debt investments for all real estate property types.

D. Asset Selection Criteria

Analysis of potential real estate hybrid debt investments will be based on the physical, locational, and economic characteristics described in detail in the Investment Criteria in the individual core sector policies.

Physical attributes considered should include the site, property size, exterior and interior characteristics, and building services, and amenities. Locational standards considered should include the socioeconomic market, neighborhood and site characteristics. Economic standards encompass analysis of the income and expense potential determining future cash flow and value enhancement.

E. Investment Vehicles

The System shall invest in real estate hybrid debt investments through investment advisors. Investment advisors shall provide expertise and experience in negotiating the complex real estate hybrid debt agreements. The advisors may present direct investment or commingled fund opportunities to the System. Fees paid for the advisors' services will be in relationship to the System's service requirements.

F. Selection of Investment Advisors

1. Selection of investment advisors is critical to the success of the Program. The System shall approve investment advisors based on their successful history in negotiating and monitoring real estate hybrid debt investments.

2. All advisors will be evaluated based on acquisition and asset management criteria including the following:

   a. Significant experience in origination or asset management or both of real estate hybrid debt investments

   b. Thorough understanding of the factors and issues involved in negotiating and managing real estate hybrid debt investments

   c. Proven ability to successfully negotiate real estate hybrid debt agreements

   d. Proven record of accomplishment in working with established borrowers

G. Borrowers

Borrowers shall be evaluated based on the following criteria:

1. Financial stability;

2. Significant past development or asset management experience or both with the proposed investment property type;

3. Significant local knowledge of the project's geographic area; and

4. Prior experience with real estate hybrid debt investments.

H. Investment Structure

1. Real estate hybrid debt investments have a typical structure, although the competitive forces of the market place ultimately determine the final terms of the transactions. Therefore, investment advisors shall remain flexible in negotiating such agreements. The System and its counsel reserve the right to review and approve all such agreements.

2. In general, negotiated agreements shall contain the following terms. When agreements differ from these terms, the advisor shall identify the differences and the reasons in its presentation to the System.

   a. Loan Term - The loan term shall not exceed 20 years with the preferable term in the 10-15-year range. Shorter terms are acceptable with prepayment penalty provisions.

   b. Loan Amount - In general, the loan amount should be such that the loan-to-value percentage shall not exceed 90 percent. However, the inherent uncertainty of market projections presents difficulties in determining the project's future value at the commitment date. If possible, the funding amounts for developmental projects shall undergo an appraisal at the funding date with the amount not exceeding 100 percent of the total budgeted costs or the actual costs, whichever is less.

      The advisor or a third party shall verify costs, which may include reasonable development fees. The System shall monitor construction costs during the construction phase, as it deems appropriate.

      Commitment amounts may contain an interest reserve that may pay debt services during the lease-up period for developmental projects.

c. Interest Rate - The interest rate for a loan that funds within ninety days after approval, shall not exceed 200 basis points below the conventional mortgage rate for the same term unless other terms of the transaction compensate for the lower rate. For forward commitments scheduled to fund more than ninety days after approval, interest rates should be higher to compensate for the additional risk.

d. Loan Fees - Good faith loan fees are appropriate to ensure good faith performance from the borrower. Good faith deposits made at the time of application should be posted with the System. Upon commitment, good faith deposits can apply toward the commitment fee. Upon closing, any refundable portion would be refundable to the borrower. In some cases, bilateral contracts, which require other liquidating damages besides the good faith deposit or specific performance, may be appropriate.

e. Participation in Cash Flow or Property Appreciation or Both - The participation feature may state that a percentage of cash flow or a preferred return to the System. It is preferable that the percentage of cash flow shall be at least 50 percent to compensate the System for the risk, but less than 80 percent to provide sufficient financial motivation to the borrower. The percentage should reflect current interest rates, the System's yield requirements, and the other terms of the transaction.

Participation payments should be paid at least quarterly and preferably on a monthly basis when cash flow permits.

The definition of real estate hybrid debt cash flow shall include gross revenues less operating expenses (including property management fees), debt service, and reserves for leasing commissions, property taxes, anticipated repairs, and capital improvements. The reserves shall accomplish the following goals:

(1) Spreading the recognition of the cost of such

expenditures evenly over the period of the investment

(2) Reducing the need for additional capital contributions

(3) Reducing the potential disputes concerning past distributions in the event unexpected cash needs arise relating to prior periods, such as retroactive tax increases.

The System should also participate in value increases when they are recognized at refinancing or sale. It is preferable that the percentage of participation of the residual value defined in the agreement be the same as that of participation in operating cash flow, unless other terms of the transaction justify a lower or higher percentage.

The loan agreement shall define the manner of keeping property books and identify the timing and scope of an independent periodic audit of the property books. Property records shall comply with the System's Real Estate Accounting Policy and Reporting Guidelines. Distributions should be paid at least quarterly and preferably monthly.

f. Conversion Terms and Timing – The debt agreement shall include the conversion terms, including percentages available for purchase, and the conversion date. Preferably, the conversion option shall be for not less than 50 percent ownership, thereby giving the System control of the investment.

By preference, the System shall have the option to convert after five-to-seven years, but no later than 10 years after loan funding, and at the end of the loan term. Multiple conversion date options are highly desirable.

The loan document shall include procedures for reconciling a disagreement over the purchase price. In the case of default, the conversion agreement shall be separately structured from the mortgage agreement and shall not be included as an additional remedy.

g. Earnouts, Holdbacks, and Other Incentives - Where possible, the investment structure shall include incentives for the borrower to manage the property to achieve the highest long-term return for the System.

h. Amortization: Loans shall be amortizing. Loans may be interest only or negatively amortizing for a small portion of the loan term if the participation or conversion features are sufficiently attractive to compensate for the additional risk. Loans that have an expected negative accrual (usually from interest due) shall be structured so that the expected accrual amount is included in the original commitment as a reserve. The reserve shall not be greater than 10 percent of the original funding.

i. Debt Service Coverage - The debt service coverage ratio shall not be less than 1.05 times for a convertible loan or less than 1.10 times for participating only loans for any year without an interest reserve included in the loan budget. If applicable, full disbursement of the remaining interest reserve to the borrower shall not occur until the property achieves the target debt service coverage for a minimum of one year.

j. Payment - Generally, no prepayment is allowed during the first half of the loan term or prior to the first conversion option date. Prepayment during the second half of the loan term shall include appropriate yield maintenance penalties, which include compensation for participation and equity conversions and contractual interest. Prepayment options must coincide with conversion options or the System's "call" option.

k. Additional Capital Requirements. Provisions shall be made for the funding of additional capital requirements. These additional requirements may include tenant improvements or leasing commissions beyond the budget. To maintain a clear position for the System as lender, the borrower should be responsible for all additional capital requirements. Preferably, reserves shall provide the financing of additional capital requirements as described above. Should reserves be depleted, or determined to be inadequate for future needs, the borrowers' own funds may pay additional contributions. The System may fund the additional capital requirements with the additional funding added to the loan balance, or a change made in the participation percentages, or both. The System shall not provide additional capital to fund debt service payments.

l. Transfer of Interests - At any time during the loan term, the borrower shall have the right to sell only with the System's consent and approval of the new owner. The System should have the right to buy the property at the price offered to the third party.

m. Call Option - It is preferable that the System have the right to "call" the loan if certain provisions are not met, for example, if additional required capital is not provided.

n. Second Mortgages - The borrower shall place additional mortgages on the property only with the System's consent. If the borrower places additional mortgages on the property, the total debt service coverage shall be at least 1.10 times. The System's participation in property cash flow shall be calculated before the debt service in the second mortgage. Additionally, if exercising its equity conversion option, the System shall receive its share of the additional proceeds.

o. Guarantees - The System prefers borrower guarantees for loans on properties that have not yet reached breakeven. The guarantee shall cover debt service requirements until the property reaches the minimum debt service coverage ratio.

p. Decision making - Preferably, the System shall review and approve all major operating decisions. Major operating decisions include major leases, leasing plans, operating budgets, capital improvement expenditures, property management agreements, over-budget expenses, timing of refinancings, and timing of sales. The System prefers to specify the limits of insurance coverage and to request verification of such insurance. The borrower is responsible for daily property management decisions.

The borrower may perform property management in-house or may contract the services out to a property management firm. The Real Estate Hybrid Debt Investment Agreement shall provide for the System's right (according to ownership percentages) to approve the selection of the property manager and to terminate the manager with reasonable cause.

q. Foreclosure/Default Protections - Where possible, the System shall strive for contract terms emphasizing the following protections:

(1) Maximum control during default;

(2) Loan workouts and foreclosure;

(3) Streamlined foreclosure processes to the extent allowed under local law; and

(4) The enforcement of minimum property maintenance standards during default and foreclosure periods.

IV. GENERAL

Hybrid debt investments are defined as mortgages having debt and equity features. The specific debt and equity features vary according to the real estate hybrid debt structure. Three examples of real estate hybrid debt investments are as follows:

A. Participating Mortgages: The lender's return includes a contractually agreed upon amount of interest plus potential contingent interest expressed as a percentage of property operating cash flow, or a percentage of property appreciation upon sale or refinancing, or both.

B. Convertible Mortgages: The loan structure includes a contractually agreed upon amount of interest and an option to convert a portion or all of the loan balance into a percentage of equity at a specified date.

C. Convertible Participating Mortgages: The loan structure includes contractual interest, an option to convert part or all of the loan balance into equity at a specified date, and a percentage participation in property cash flow or appreciation upon sale or refinancing, or both.

V. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

Earnouts - A dollar amount held back until the event is completed. That is, a seller of a property will earn a portion of their price upon achieving a pre-established lease-up level.

Holdbacks - A specified dollar amount held back from being distributed to the borrower, until a certain event is completed.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
REAL ESTATE INVESTMENT MANAGER MONITORING PROGRAM – EXTERNALLY MANAGED

August 11, 1999

This Policy is effective immediately upon adoption and supersedes all previous external real estate investment manager monitoring policies.

I. PURPOSE

This document sets forth the investment Policy ("the Policy") for the External Real Estate Investment Manager Monitoring Program ("the Program"). External investment managers ("Management Firms") are expected to invest the California Public Employees' Retirement System's ("the System") assets in accordance with the specific guidelines included in their contracts. When Management Firms are retained, they may be given discretion over the selection of individual assets in a portfolio, subject to an approved matrix of investment guidelines. Management Firms also may have an ownership interest and co-investment.

II. MONITORING OBJECTIVES

Under the direction of the Board and senior management, the Investment Staff shall create and manage the implementation of investment strategies and policies in the System's externally managed real estate investment portfolios.

The System may allocate assets to Management Firms for constructing an investment program that meets its overall performance objective. These assignments are made pursuant to a specific performance objective, risk profile, and implementation process for that portfolio designed to maximize the System's total return versus the risk incurred. Ensuring that each portfolio achieves its strategic risk and return objective(s) within the established parameters, portfolios must be monitored for compliance with the criteria specific to its particular mandate.

Outlined below are the monitoring objectives of the Program:

A. Evaluate whether Management Firms have achieved their stated investment objectives;

B. Ensure that Management Firms adhere to their specific investment process; and

C. Assess the impact of any significant Management Firm changes, such as staff, client base, structure, or ownership.

III. RESPONSIBILITIES AND DELEGATIONS

A. The **System's Investment Committee** ("Investment Committee") is responsible for approving and amending the Policy and delegates the responsibility for administering the Program to the Staff through the Delegation of Authority (Delegation Nos. 89-13 and 95-50).

B. The **System's Investment Staff's** ("the Staff") duties include, but are not limited to, the following:

1. Developing specific guidelines, outlining the Management Firm's strategy, portfolio characteristics, authorized investments and markets, benchmarks and performance objectives. These guidelines are part of the contractual agreement with each firm;

2. Developing and recommending the Policy to the Investment Committee;

3. Developing and maintaining a procedures manual subject to periodic reviews and updates outlining Staff operational procedures to be used in implementing this Policy;

4. Implementing and adhering to the Policy;

5. Recommending action concerning the Management Firms retained for implementing the Program in accordance with the Policy. The Investment Staff shall also recommend changes in the firm's contractual guidelines or any other aspects Staff considers pertinent; and

6. Reporting to the Investment Committee, periodically, about the performance of the Program, and monitoring Policy implementation and compliance. Staff shall report all violations of the Policy to the Investment Committee, along with explanations and appropriate recommendations for corrective action.

C. The Management Firm is responsible for all aspects of portfolio management as set forth in the firm's contract with the System and shall have the following duties:

1. Communicate with the Staff as needed regarding investment strategy and investment results. The Management Firm is expected to monitor, analyze and evaluate performance relative to the agreed-upon benchmark.

2. Cooperate fully with the System's Staff, the Custodian, and consultant(s) on requests for information.

D. On request by the System, the Real Estate Pension Consultant shall be responsible for independently monitoring and evaluating the Management Firms. The Real Estate Pension Consultant shall report recommendations, if any, directly to the Investment Committee on a quarterly basis, in accordance with the terms of its contract.

IV. MANAGEMENT FIRM EVALUATION

The ongoing evaluation of Management Firm includes a periodic, written evaluation based on qualitative and quantitative criteria.

A. Qualitative Criteria

Qualitative monitoring involves reviewing organization aspects: ownership, staffing, growth, client service, investment approach, business risk, and regulatory issues. Consideration will also be given to the financial strength of the investment management organization, the level of client service given the System, and changes within the managing organization such as the continuity of personnel assigned to the System's investments.

B. Quantitative Criteria

Quantitative monitoring requires analysis concerning the implementation of the investment approach: asset selection, performance, and portfolio risk.

C. Contract Review Status

When quantitative or qualitative factors evaluating Management Firms deteriorate, appearing likely to affect long-term overall performance, the Management Firm shall be placed on Contract

Review Status. The three levels of Contract Review Status are Watchlist, Probation, and Dismissal, and are outlined as follows:

1. **Watchlist** status indicates an increased level of concern, but does not indicate major deficiencies. A recommendation for Watchlist status shall designate a period to assess the capabilities and quality of a manager's operations. Management Firms shall typically remain on Watchlist for performance-related issues or organizational changes for up to one year in order to ensure that outstanding issues are resolved. Management Firms not correcting their outstanding issues in a timely manner shall advance to a more critical phase of Contract Review – Probation Status or Dismissal.

2. **Probation** status indicates a level of serious deficiency. It indicates a need for more frequent contact with the firm to monitor closely conditions leading to its placement on Probation.

3. **Dismissal -** Staff shall recommend dismissal of a manager if adequate improvement in the areas outlined in the Plan of Action has not been made. However, the Staff may recommend dismissal for any reason upon a thirty-day notice to the manager.

V. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

Management Firms – External Investment Managers

Watchlist Status – Indicates a level of concern, the degree of which shall be unique to each situation and quantified by Staff to the Investment Committee.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
REAL ESTATE SALE-LEASEBACK

March 26, 1999

This Policy is effective immediately upon adoption and supersedes all previous real estate sale-leaseback investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for Real Estate Sale-Leaseback Investments ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of real estate.

II. STRATEGIC OBJECTIVES

A. Achieving the highest total rate of return possible, consistent with a prudent level of risk and the liabilities of the System and the investment guidelines contained herein, is the strategic objective of the program. The Program shall be considered a component of the Specialized Equity Real Estate Portfolio. As such, the Program shall achieve an appropriate risk- adjusted return. The System's sale-leaseback real estate investments (referred to herein collectively as the "Portfolio") shall be managed to assist the System in achieving its long-term objective of exceeding a minimum target real rate of return of 6.0% (after fees). Sale-leaseback investments shall achieve a real rate of return consistent with other equity real estate investments of similar risk.

   The performance benchmark of shall be the National Council of Real Estate Investment Fiduciaries (NCREIF) or National Association of Real Estate Investment Trusts (NAREIT) indices, or other comparable indices or custom indices, if available. Target returns shall be based on the System's minimum 5% overall real return objective for the Core Real Estate Portfolio, with additional return requirements accounting for specific risks associated with sale-leaseback investments.

B. The Program shall be managed to accomplish the following:

1. Provide diversification to the System's overall investment program;

2. Preserve investment capital and generate attractive risk-adjusted rates of return for the System;

3. Provide a hedge against inflation; and

4. Consider solely the interest of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVE

Target returns shall be based on the System's minimum 5% overall real return objective for the Core Real Estate Portfolio, with additional return requirements accounting for specific risks associated with sale-leaseback investments.

IV. INVESTMENT APPROACHES AND PARAMETERS

A. **Risks**

Primary risks associated with the Program are two-fold:

1. Tenant credit risk

2. Real estate risk

Tenant credit risks include risks associated with relying on the business success of usually one tenant and that tenant's ability to pay rent, other property expenses, and maintenance obligations of the property. Comprehensive evaluation of the credit-worthiness of the lessee, proper structuring of the lease includes financial covenants and event risk clauses. The continuous monitoring of the financial health of the lessee throughout the lease term can significantly minimize exposure to tenant credit risks. The structure of leases to corporations ensure a priority position to unsecured, general obligation bonds, which mitigates the risk of loss in bankruptcy.

The Program is also subject to the general risks associated with the ownership of real estate. Those risks include adverse changes in economic conditions, property supply and demand, as well as tax and environmental laws. In particular, functional and economic obsolescence, locational demise, environmental problems, and extensive specialized tenant improvements are all factors that potentially diminish the marketability of a sale-leaseback property in the future. Of particular concern are factors such as a tenant's space needs, which impact the tenant's long-term commitment to a property. Real estate risks can be mitigated by comprehensive due diligence, real estate underwriting, and continuous monitoring of the real estate investments.

B. **Diversification**

Real Estate sale-leaseback investments of core properties shall follow the diversification guidelines for core properties as included in the Statement of Investment Objectives and Policies for the Equity Real Estate Portfolio. The System recommends the diversification of the Program by geographic region and property type. Additionally, the System shall seek diversification by industry type avoiding excessive concentration in one particular industry group for the core and specialized portfolios.

C. **Investment Objectives and Criteria**

1. Size

Real estate sale-leaseback investment size at the property or portfolio level shall depend on the opportunities available to the System, with neither small nor large investments dominating the Portfolio. The size of sale-leaseback investments shall be consistent with the guidelines included in the Statement of Investment Objectives and Policies for the Equity Real Estate Portfolio. Typically, individual sale-leaseback investments range in size from $5 million to $50 million, with portfolios of sale-leaseback properties ranging from $50 million to more than $300 million.

2. Structure

The Program shall have a standardized investment structure, although the competitive forces of the market place ultimately determine the final terms of the transaction. Therefore, investment advisors shall remain flexible in negotiating such agreements. The System and its counsel reserves the right to review and approve such agreements.

3. Vehicles

Direct investment is the preferred means of investing in the Program. Direct investment is favored over indirect fund investment due to the System's ability to commit sufficient funds for diversifying its portfolio, achieving lower fees, and exercising increased control over the formulation of sale-leaseback investments.

4. Selection of Advisors and Management Firms

Investment advisor skills are critical to the success of the Program. The System shall invest in real estate sale-leaseback investments on a direct basis through its core investment advisors and managers selected for implementing specialized investment strategies where sale-leaseback structures are appropriate. Investment advisors shall have demonstrated expertise and experience in sourcing, negotiating, monitoring, and disposing of sale-leaseback investments.

5. Investment Criteria

Investment selection shall be oriented towards, but are not limited to, the following areas:

a. Corporate headquarter office buildings;

b. Data processing centers and other office facilities;

c. Regional warehouse distribution facilities ; and

d. Single tenant retail buildings.

Additionally, the following tenant, lease, and property characteristics are critical to the success of real estate sale-leaseback investments. In general, they shall be contained in the negotiated agreements. When agreements differ from these terms, the advisors or management firms shall identify the differences to the System.

(1) **High Quality Credit Tenants -** Tenants shall generally possess the following; an investment grade rating (generally BBB and above, or the equivalent); favorable positioning in a stable or growing market or business niche; strong financial performance; favorable business prospects or outlook; and shall not be subject to excessive leverage. High quality tenants are critical to low re-leasing risk, which is important in investments in single-tenant buildings.

(2) **Long-term Lease -** The lease terms shall generally range from 10 to 20 years. Leases of this length allow for the sale of the investment in years 5 to 10 with a marketable lease term remaining. Consideration of shorter leases may occur under special circumstances such as when properties possess below market rents, strong tenant demand, superior location, and/or expansion potential.

(3) **Triple-net Leases -** Leases shall obligate the tenant to pay for all or substantially all operating expenses and capital expenditures.

(4) **Rent Increases -** Additionally, the structure of leases shall include periodic rent escalations tied to the Consumer Price Index (CPI) or based on negotiated fixed increases. During periods of low to moderate inflation, these rent increases generally provide adequate inflation protection.

(5) **Financial Covenants and Event Risk Language** - Leases shall contain financial disclosure and event risk clauses such as anti-dilution provisions and net worth tests for protection against loss of value because of a financial event that could diminish the credit-worthiness of the tenant. The structure of leases shall ensure that the tenant is required to pay rent under all circumstances. The lease structure shall protect the System from unexpected financial obligations in the normal course of operations as well as under troubled circumstances.

(6) **Competitively Located Properties in Strong Markets -** Properties shall be well located in markets with favorable supply and demand characteristics.

6. Asset Management

The Program is generally less management intensive than other types of real estate investments due to the triple-net lease structure requiring that the lessee be responsible for operating costs and capital expenditures. However, particular management requirements shall vary by property type.

Management firms shall represent the System's interests in asset management decisions and oversee or provide daily property management services, as expertise and organizational structure allows. Management firms shall receive the appropriate delegation of authority along with the responsibility for providing appropriate measures of accountability. Advisors shall represent the interests of the System only in these transactions or the interests of the investor group only if the System co-invests with other clients in such transactions.

Appropriate financial and operational controls and reporting requirements shall apply to real estate sale-leaseback investments. This shall include audited financial statements on a basis consistent with the System's accounting policy.

V. BENCHMARK

The performance benchmark of the Program shall be the National Council of Real Estate Investment Fiduciaries (NCREIF) or National Association of Real Estate Investment Trusts (NAREIT) indices, or other comparable indices or custom indices, if available.

VI. GENERAL

Real Estate sale-leaseback properties are typically single-tenant properties acquired and leased back to their former owners on a triple-net basis. They may be categorized as core or specialized investments depending on their risk-and-return attributes and the nature of the underlying real estate.

Real estate sale-leaseback investments have bond-like characteristics. They typically provide a stable, predictable cash flow, act as a moderate inflation hedge, and have lower volatility than multi-tenanted property investments due to the long-term contractual nature of their income stream. Additionally, triple-net leases obligate the tenant to pay for all, or substantially all, operating expenses and capital expenditures, thereby reducing the owner's exposure to unpredictable operating costs. Advantages to investing in real estate sale-leaseback properties include stable, predictable cash flows, and reduced volatility resulting from long-term leases and competitive income returns. Furthermore, long-term leases generally reduce the frequency of re-leasing risk, the cost of commissions and tenant improvements, and, often, downside exposure in a weak market.

Because of the lengthy term of most of the leases tied to these investments and their consistency of income stream, real estate sale-leaseback investments typically do not offer significant upside (appreciation) potential. However, during downturns in the real estate market, sale-leaseback investments shall commonly outperform core real estate due to their income orientation and credit quality of the tenants. During periods of real estate market recovery, these investments are likely to trail the benchmark indices because there may be no opportunity to re-lease a sale-leaseback property for higher rents.

VII. ASSET ALLOCATION

Allocations to the Program shall be consistent with allocation parameters for core and specialized investments in the Statement of Investment Objectives and Policies for the Equity Real Estate Portfolio. Additionally, the particular attributes of these investments (e.g., income versus growth orientation) shall be noted when making allocation decisions.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
SENIOR HOUSING PROGRAM

November 13, 2000

This Policy is effective immediately upon adoption and supersedes all previous senior housing real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Senior Housing Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with senior housing investment.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return possible, consistent with a prudent level of risk, the liabilities of the system, and investment guidelines contained herein is the strategic objective of the Program.

The Program shall be considered a component of the Specialized Equity Real Estate Portfolio and, as such, shall be required to achieve an appropriate risk-adjusted return. The Program shall be managed to assist the System in achieving its overall long-term objective of exceeding a minimum target real rate of return of 6% (after fees) while maintaining a prudent level of risk.

The Program shall be managed to accomplish the following:

A. Preserve investment capital;

B. Generate attractive risk-adjusted rates of return for the System as a total return investor;

C. Provide a hedge against inflation; and

D. Consider solely the interests of the System's participants and beneficiaries in accordance with California State Law.

III. INVESTMENT APPROACHES AND PARAMETERS

A. Risks

There are specific risks associated with investment in the senior housing industry, which shall be carefully mitigated and monitored by the System. The primary risks include, but are not limited to, the following:

1. Regulatory Risk – Regulatory and reimbursement requirements of the industry are complex. Preference to private-pay properties shall mitigate exposure to pertinent reimbursement regulations.

2. Operating and Business Risk – Senior housing is an operating service business as well as a real estate investment. The risk shall be mitigated by careful selection of experienced, professional operators who are licensed if required by law.

B. Diversification

The Program shall be well diversified to minimize risk due to overexposure to any one risk factor. The Program shall be diversified by geography, product type, investment manager, and operator. From time to time, adjustments to correct the actual investment to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

The System shall periodically review the Portfolio and Guidelines. The System shall notify the partners when the Portfolio violates diversification guidelines or portfolio leverage.

1. Diversification by Geography

   The Program shall diversify by geography. Major urban and suburban markets and submarkets shall be considered, but not more than 33% shall be invested in any single Metropolitan Statistical Area (MSA).

2. Diversification by Product Type

   The System shall employ three product types for Program investment. Allocation ranges for each product type have been established as follows:

Product Type	Allocation Range
Independent Living	0 – 75%
Continuing Care Retirement Communities	0 – 65%
Assisted Living	0 – 40%

3. Diversification by Operator

"Operator" refers to any individual, partnership, limited liability company or other entity employed to manage the Senior Housing projects' day-to-day business and affairs on behalf of the Partnership.

The Program shall consider diversifying among various Operators to avoid business risk associated with a single entity. Operators shall represent expertise in a range and diversification of product types. The selection of Operators shall be based on financial strength and industry expertise. The desired operators shall be leading companies with at least three years' experience in the senior housing industry.

No more than 33% of total capital shall be committed to any one operator.

4. Diversification by Investment Manager

The Program shall diversify investments such that no one-investment manager shall dominate.

C. **Investment Objectives and Criteria**

1. Independent Living Facilities

a. "Independent Living Facilities" refers to properties that include multi-unit residential facilities for senior citizens where most residents receive supportive hospitality services such as meals, housekeeping, transportation, and social programs, as well as not more than minimal assistance with daily living activities.

b. Investment Criteria

(1) Age of Buildings: No more than 25 years, unless a redevelopment/rehab is contemplated or has been completed since construction or the property possesses an infill location;

(2) Location: Strong preference for proximity to health care providers and public transportation if not otherwise provided by the facility;

(3) Size: 100 units or greater;

(4) Minimum Square Footage: Studio, 1BR, 2BR – no units below 350 square feet;

(5) Amenities: Adequate public facilities for recreation and meals;

(6) Care Continuum: Preference for assisted living units to provide continuum of care; and

(7) Each project shall be required to produce a projected minimum total real rate of return (after fees) of 6%.

2. Assisted Living Facilities

a. "Assisted Living Facilities" refers to properties that include multi-unit residential facilities for senior citizens where most residents receive supportive hospitality services such as meals, housekeeping, transportation, and social programs, as well as 24-hour protective Oversight and significant assistance with daily living activities.

b. Investment Criteria

(1) Age of Buildings: No more than 12 years, unless a redevelopment/rehab is contemplated or has been completed since construction or the property possesses an infill location;

(2) Location: Strong preference for proximity to health care providers;

(3) Size: 40 units or greater;

(4) Minimum Square Footage: 1BR, 2BR – no units below 250 square feet;

(5) Amenities: Adequate public facilities for meals;

(6) Care Continuum: May or may not include Alzheimer's care units; and

(7) Each investment shall be required to produce a projected minimum total real rate of return (after fees) of 7%.

3. Continuing Care Retirement Facilities

a. "Continuing Care Retirement Community" refers to multi-unit residential communities for senior citizens that are comprised of Independent Living units, Assisted Living units and units designed for providing skilled nursing care.

b. Investment Criteria

(1) Age of Buildings: No more than 30 years, unless a redevelopment/rehab is contemplated or has been completed since construction or the property possesses an infill location;

(2) Location: Strong preference for proximity to health care providers;

(3) Size: 175 units or greater;

(4) Minimum Square Footage: Mix of Independent Living, Assisted Living, and Skilled Nursing units whereby Independent Living typically comprises the greatest component of units;

(5) Amenities: Adequate public facilities for recreation and meals; and

(6) Each investment shall be required to produce a projected minimum total real return (after fees) of 7%.

D. **Structure**

1. Leverage

The System desires an appropriate and diversified use of leverage. A range of leverage at investment level and entity level may be used by the System's partners.

The maximum amount of leverage on the Portfolio shall be 65% loan to market value.

2. Equity Co-investment

   Equity requirements shall be set by the Program Guidelines. The System recognizes that the financing markets for senior housing projects are dynamic; therefore, the System shall review and reconsider the equity requirements, as set forth in the Program Guidelines, every six months.

E. **Investment Vehicles**

Limited Partnerships, limited liability companies, Real Estate Operating Companies, commingled funds, and separate accounts shall all be considered appropriate investment vehicles for implementing investments in this property type. In all cases, the System's investment and risk of loss shall be limited to the amount initially committed. The System and its partners shall structure transactions and utilize vehicles to minimize tax-related issues.

IV. PARTNER RESPONSIBILITIES

A. **Definition**

Partnership refers to the limited partnership or limited liability company or other entity formed to manage the Portfolio's business and affairs. The System shall be a limited partner or member. The managing member or general partner shall be responsible for the day-to-day business and affairs of the Portfolio on behalf of the Partnership.

B. **Responsibility**

The partner responsibilities shall include the fiduciary responsibility to invest and manage the System's funds in this property type in a manner consistent with the Program Guidelines as revised from time to time (in effect at the time each project commitment is made by a partner), and within the limits set by this Policy.

C. **Discretion**

The partners have investment discretion regarding all project investment decisions; however, they shall comply with the stipulations outlined in the Policy regarding System approvals.

D. **Reporting**

The System shall require that the partners make periodic reports as requested. The System shall also have the right to audit and review the books, records, and operations of the partners. Such reviews may be conducted either by the System Staff or by consultants at the System's discretion.

E. **Conflicts of Interest**

The Partners shall fully disclose to the System any existing relationships that may be conflicts of interest as part of the Partners' standard reporting procedures.

V. GENERAL

A. Investment in the Program shall include direct or partnership investments where the predominant end use is residential age-restricted facilities including Independent Living, Assisted Living and Continuing Care Retirement Communities (CCRC). Incidental commercial/multi-family infrastructure lot development, including golf course construction, may be undertaken in the Senior Housing Program with certain restrictions.

B. This Policy contains a Glossary of Terms in Section VIII of this document.

VI. ASSET ALLOCATION

The following is the current asset allocation range for the Program, as a percent of the total allocated Specialized Equity Real Estate Portfolio:

	Range
Senior Housing Program:	0 – 15%

From time to time, the actual investment may fall out of the range prescribed by Policy. In these instances, adjustments to correct the actual to comply with the Policy allocation range shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

VII. PROJECT MANAGEMENT

Management Firms and Partners shall represent the System's interests in project management decisions and oversee or provide daily project management services, as expertise and organizational structure allows, and act in a fiduciary capacity. The System shall give appropriate Delegation of Authority and provide adequate measures of accountability to Management Firms and Partners.

VIII. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the CalPERS Master Glossary of Terms.

Assisted living - Assisted living refers to properties that include multi-unit residential facilities with supportive hospitality services such as meals, housekeeping, transportation, and social programs, as well as 24-hour protective services and personal care assistance.

Continuing care retirement - Continuing care retirement communities refers to senior housing properties that provide a full continuum of care to meet the changing needs from independent living to nursing care.

Independent living - Independent living refers to properties that include multi-unit residential facilities with supportive hospitality services such as meals, housekeeping, transportation, and social programs.

Operator - any individual, partnership, limited liability company, or other entity employed to manage the Senior Housing Program's projects' day-to-day business and affairs on behalf of the Partnership.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
SINGLE-FAMILY HOUSING PROGRAM

November 13, 2000

This Policy is effective immediately upon adoption and supersedes all previous single-family housing acquisition and development real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Single-Family Housing Acquisition and Development Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with single-family housing investment.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return possible consistent with a prudent level of risk, the liabilities of the System, and investment guidelines herein is the strategic objective of the Program.

The Program shall be considered a specialized component of the specialized equity real estate portfolio and, as such, shall be required to achieve an appropriate risk-adjusted return. The *primary* emphasis of the Program is in the state of California. The Program shall be managed to assist the System in achieving its overall long-term objective of exceeding a minimum target real rate of return of 8% (after fees) while maintaining a prudent level of risk.

The Program shall be managed to accomplish the following:

A. Preserve investment capital;

B. Generate attractive risk-adjusted rates of return for the System as a total return investor;

C. Provide a hedge against inflation; and

D. Consider solely the interest of the System's participants and beneficiaries in accordance with California State Law.

III. INVESTMENT APPROACHES AND PARAMETERS

A. **Risks**

There are risks associated with investment in the single-family residential housing industry. The primary risks include, but are not limited to, the following:

1. Land Entitlement Risk

    a. Land entitlement risk reflects the risks assumed by an investor when purchasing a parcel of land prior to the tentative map and other discretionary political approvals being granted by the appropriate regulatory bodies (i.e., municipalities or planning agencies, or both) as to the final use of the property.

    b. In order to limit this risk, the System shall invest primarily in land where a tentative map for the project has been obtained. The Program exposure to unentitled land shall generally not exceed 20% of the actual invested total Housing Program Portfolio.

2. Project/Development Risk

    a. Investment in single-family residential development and construction entails assuming the normal risks associated with development of this property type.

    b. These risks, some of which are controllable, include, but are not limited to, the following: cost overruns, project delays, contractor disputes, ineffective marketing, slow sales, price modifications, and potential litigation.

    c. Partners who are selected by the System to manage funds invested in this property type shall be expected to undertake all appropriate steps to mitigate these risks.

3. Interest Rate Risk

   a. Fluctuating interest rates affect the affordability of housing for all buyers, especially for price-sensitive first-time buyers.

   b. The risk to the investor and homebuilder is that the standing inventory of homes may remain unsold for an extended period of time.

   c. The risk can be mitigated by careful economic analysis of market cycles, limited project life cycles, controlled standing inventory (by limiting starts ahead of sales), and maintained flexibility on pricing.

   d. Interest rate risk can also be partially mitigated by using interest rate hedging.

   e. Partners who undertake to manage invested funds in this property type shall be expected to closely examine strategies to mitigate interest rate risks and execute such strategies when appropriate.

B. **Diversification**

The Program shall be well diversified to minimize risk due to overexposure to any one risk factor. The Program shall be diversified by geography, strategy, product type, price mix, builder, project, and development life cycle. From time to time, adjustments to correct the actual investment to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

The System shall periodically review the Portfolio and Program Guidelines. The System shall notify the partners when the Portfolio violates diversification guidelines and portfolio leverage.

1. Diversification by Geography

   The Program shall diversify by geography. Major urban and suburban markets and submarkets shall be considered, but not more than 25% shall be invested in any single Metropolitan Statistical Area (MSA). California is the current primary focus of the Program, but the System shall consider investments outside of California. In considering such investments outside of California, the System shall maintain or strive to increase commitments within California consistent with its fiduciary obligations. The geographic allocation shall be reviewed periodically to determine appropriate levels.

2. Diversification by Strategy

The System shall employ a broad range of strategies for Program investment. Allocation ranges for each strategy have been established and are listed below. To mitigate risk, the System shall place less emphasis on strategies carrying a greater degree of uncertainty.

Strategy	Allocation Range
Housing Joint Ventures	50 – 100%
Land Development	0 – 50%
Off-balance-sheet Financing	0 – 40%
Unentitled Land	0 – 20%
Entity Level Investments	0 – 10%
Related Investments	0 – 10%

The total allocation to land development, unentitled land, and off-balance sheet financing shall not exceed 50% of the Program.

3. Diversification by Product Type

Emphasis shall be placed on owner-occupied primary residences and entry-level housing. Other product types shall be considered, including, but not limited to, the following: first-time-move-up and second-time-move-up.

4. Diversification by Price Mix

The Program shall consider ranges of lot/home pricing that are appropriate within each region and submarket. Actual price levels shall be determined by specific markets and submarkets. The Program shall encourage, but not be limited to, affordable housing projects, which otherwise meet all prudent investment criteria. Pricing of homes shall be consistent with the first, second, and third-time buyers for the particular geographic market~~,~~ within the limits otherwise established within the Policy.

5. Diversification by Builder

The Program shall consider diversifying among various builders to avoid business risk associated with a single partner entity. In the context of this Policy, "Builder" shall refer to either a homebuilder or a residential land developer. Builders shall represent expertise in a range and diversification of price mix and geography, and selection shall be based on financial strength and industry expertise. The desired Builders shall be leading developers with at least ten years' experience in the single-family housing or residential land development industry.

For the System's Investment Committee and Staff contemplating the construction of homes, the desired Builders shall be either leading homebuilders (top tier), or regional Builders with a niche focus on single-family residential development or affordable housing (second tier). For purposes of this Policy, a top-tier homebuilder is defined as one within the top 50 producers of homes within California (or the applicable state) during each of the last three years.

No more than 20% of total capital shall be committed to any one homebuilder. For the purposes of this Policy, entities that have substantial common ownership (greater than 10%) shall be considered a related entity; therefore, they shall be considered one Builder.

6. Diversification by Project

The Program shall diversify investments in such a manner that no one project shall dominate an individual partner allocation. No more than 15% of an individual Partner allocation, capped at $40 million, shall be invested in any single project without System approval.

7. Diversification by Development Life Cycle

The Program shall diversify investments such that the development life cycle shall vary. Development Life Cycle is the total time the project progresses from market entry to exit. The maximum time period for completion of the development cycle of acquisition, development, construction, and sellout shall generally be five years. The expected project life cycle, from acquisition of entitled or unentitled land through the completion of construction of the final home, should be five years or less. No project with a life cycle greater than five years are permitted without the Staff's approval, except where partnership investment capital is returned within five years.

C. **Investment Objectives and Criteria**

1. Housing Joint Ventures

a. "Housing Joint Ventures" refers to properties that are acquired with the intention to develop or construct homes (including all forms of development for single-family housing, such as condominiums, town homes, zero lot line developments, planned unit developments with and without common areas, and standard subdivisions).

b. Investment Criteria

(1) Generally, project size shall be limited to 400 units. Staff has the discretion to approve larger projects after reviewing investment parameters; and

(2) Each project shall be required to produce a minimum real rate of return (after fees) of 6%.

2. Land Development

a. "Land Development" refers to properties that are acquired with the intention to develop or construct infrastructure (including all forms of acquisition and infrastructure development for single-family housing, such as condominiums, town homes, zero lot line developments, planned unit developments with and without common area, and standard subdivisions).

b. Incidental Development

(1) Incidental commercial/multi-family infrastructure lot development may be undertaken in the Program, provided that it is not a major cost of the overall single-family project.

(2) Golf course construction may be undertaken

provided that it is an essential or required component of the overall master plan for the single-family project. Furthermore, the business plan must contemplate liquidation of the golf course at or before the end of the project.

c. Investment Criteria

(1) All Land Development investment shall meet the following conditions:

(a) Comply with the general plan and zoning ordinance of the governing jurisdiction;

(b) Comply with the provisions of the California Environmental Quality Act (CEQA) in California, or comparable local, state and federal environmental quality laws in other states;

(c) Have an approved tentative map for the master development (tentative maps for individual parcels for sale to merchant builders are not required) or, as applicable, a development agreement approved by the governing jurisdiction; and

(d) Have received any other major discretionary approvals including those of the Coastal Commission and LAFCO, as applicable or comparable local, state, and federal agencies. This condition does not include the issuance of routine procedural approvals, (e.g., Department of Transportation, Fish & Game, Corps of Engineers, grading permits, building permits, or storm water discharge permits).

(2) Generally, project size shall be limited to no more than 1500 lots. The Staff has the discretion to approve larger projects after reviewing investment parameters; and

(3) Each investment shall be required to produce a minimum real rate of return (after fees) of 8%.

3. Off-balance-sheet Financing

a. "Off-balance-sheet Financing" is a financing structure that allows a developer to improve its land without carrying the land inventory on its balance sheet. Typically, the developer is a publicly held company ("Public Builder"). The System's housing partners shall acquire the unimproved land from the Public Builder. Concurrent with the execution of the purchase and sale agreement, the partnership and the Public Builder will execute an option agreement granting the Public Builder the option to repurchase finished lots. Off-balance-sheet financed projects will be subject to the same policy requirements as conventionally financed projects.

b. Investment Criteria

(1) Project size shall be limited to the same criteria as above. The Staff has the discretion to approve larger projects after reviewing investment parameters; and

(2) Each investment shall be required to produce a minimum real rate of return (after fees) of 7%.

4. Unentitled Land

a. "Unentitled Land" refers to land that complies with the general plan but does not have a tentative map, specific plan approval, zoning, or a development agreement from the governing jurisdiction.

b. Investment Criteria

(1) Generally, project size shall be limited to the same criteria as Housing Joint Venture and Land Development. The Staff review of investment parameters; and

(2) Each investment shall be required to produce a minimum real rate of return (after fees) of 10%.

5. Entity Level Investments

a. “Entity Level Investments” refers to investments in debt, equity, or hybrid securities of entities whose principal assets are residential real estate.

b. Investment Criteria

(1) The System shall not make passive investments in publicly traded securities under this Program.

(2) The minimum real rate of return (after fees) shall be determined on a case-by-case basis, depending on the applicable risk factors and structure of the investment opportunity.

6. Related Investments

a. “Related Investments” refers to other forms of investment not described above, debt or equity, related to Housing Joint Ventures, Land Development, Off-balance-sheet Financing, Unentitled Land, or Entity Level Investments.

b. Investment Criteria

(1) Generally, project size shall be limited to the same criteria as Housing Joint Venture and Land Development. The Staff has the discretion to approve larger projects after reviewing investment parameters; and

(2) The minimum real rate of return (after fees) shall be determined on a case-by-case basis, depending on the applicable risk factors and structure of the investment opportunity.

D. **Structure**

1. Leverage

The System desires an appropriate and diversified use of leverage (e.g., third-party entity, Mello-Roos, or other project financing debt). A range of leverage at investment level and entity level may be used by the System’s partners.

The maximum amount of leverage on the Program Portfolio shall be 60% of cost or market value, whichever is greater. Leverage on individual projects shall not exceed 75% of cost or market value, whichever is greater. A temporary out-of-compliance period shall be allowed up to 75% leverage on the Program for no more than a six-month period, in which the General Partner's cash flow projection shows the Program returning to a 60% leverage ratio or less. In the event that the six-month period is not met, or projections exceed the temporary adjustment period, a capital call shall be made on the applicable partner or new investments in the applicable partnership shall cease. Unentitled Land shall not be leveraged unless it is favorable, non-recourse seller financing.

2. Equity

Equity requirements shall be set by the Program Guidelines. The System recognizes that the financing markets for homebuilding projects are dynamic; therefore, the System shall review and reconsider the equity requirements, as set forth in the Program Guidelines every six months.

E. **Vehicles**

Limited partnerships, limited liability companies, real estate operating companies, commingled funds, and separate accounts shall all be considered appropriate investment vehicles for implementing investments in this property type. However, any such vehicle chosen shall have a finite life and a requirement that the investment be self-liquidating at a time the System considers appropriate. In all cases, the System's investment and risk of loss shall be limited to the amount initially committed. The System and its partners shall structure transactions and utilize vehicles to minimize tax-related issues.

F. **Program Guidelines**

1. The System shall maintain standardized Program Guidelines in the Staff Operations Manual, which establishes operating definitions of program commitment periods, priority returns due the System, and partner fees allowable. Program Guidelines may be changed from time to time in response to changing market conditions.

2. Program parameters in the Program Guidelines shall be developed by the real estate staff and the real estate consultant as appropriate, and are subject to the approval of the Investment Committee. Important program parameters shall include the following:

   a. Program Size - Funds allocated to the market segment;

   b. Timing - Target date for investment of allocated funds;

   c. Diversification - Target allocation of funds among geographic regions and submarkets within the market segment, as appropriate;

   d. Investment Guidelines - Specification of the investment guidelines for acceptable investments within the market segment; and

   e. Asset and Project Management - Specification of the expected value-enhancing activities that shall result in maximizing returns to the System.

3. Unless specifically delegated in the contract, decision making in the Program shall be governed by the Delegations of Authority.

IV. PARTNER RESPONSIBILITIES

A. Responsibility

The partner responsibilities shall include fiduciary responsibility to invest and manage the System's funds in this property type in a manner consistent with the Program Guidelines, as revised from time to time (in effect at the time of each project commitment by a partner), and within the limits set by this Policy.

B. Discretion

The partners shall have investment discretion regarding all project investment decisions; however, they shall comply with the stipulations outlined in the Policy regarding System approvals.

C. Reporting

The System shall require that the partners make periodic reports as requested. The System shall also have the right to audit and review the books, records, and operations of the partners. Such reviews may be conducted either by System Staff or by consultants at the System's discretion.

D. Conflicts of Interest

As part of the partners' standard reporting procedures, the partners shall fully disclose to the System any existing relationships that may qualify as conflicts of interest.

V. GENERAL

A. Investment in the Program shall include direct or partnership investments where the predominant end-use is for-sale residential property or finished residential lots. This shall include single-family home construction as well as infrastructure development construction (including all forms of acquisition and infrastructure development for single-family housing, such as condominiums, town homes, zero lot line developments, planned unit developments with and without common areas, and standard subdivisions). Incidental commercial/multi-family infrastructure lot development, including golf course construction, may be undertaken in the Program with certain restrictions.

B. This Policy contains a Glossary of Terms in Section VIII of this document.

VI. ASSET ALLOCATION

The following is the current asset allocation range for the Program, as a percent of the total allocated Equity Real Estate Portfolio:

	Range
Single-family Housing Program:	5 – 15%

As a percent of the total allocated Specialized Portfolio, this Program shall range from 15 to 35%.

From time to time, the actual investment may fall out of the allocation ranges prescribed by the Policy. In these instances, adjustments to correct the actual to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

VII. PROJECT MANAGEMENT

Management Firms and Partners shall act in a fiduciary capacity, representing the System's interests in project management decisions, and providing daily project management services, as expertise and organizational structure allow. The System shall give appropriate Delegation of Authority to management firms and require that they provide adequate measures of accountability.

A. Investor Approval

The System shall require that it be informed of, but shall not participate in, the resolution of significant events that affect the investment and development process. Examples of these events include significant project cost overruns, schedule delays, contractor disputes, or commencement of litigation, and so forth. The System's approval rights shall be limited to those matters specified in this Policy and the Program Guidelines, approval of partnership level debt, major modifications of the partnership's investment structure, settlement of claims in excess of $500,000, contracts with partners' affiliates, and other major partnership events.

B. Periodic Review

Partner relationships shall be subject to periodic review by the System. System review shall include, but not be limited to, the following:

1. Original project schedules compared to actual deliveries;

2. Actual-compared-to-projected profit margins and absorption rates; and

3. Actual-compared-to-projected returns, current and forecasted capital environments, market conditions, portfolio leverages, portfolio diversifications, and adherence to Policy and Program Guidelines.

VIII. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

Housing Joint Ventures - Housing joint ventures refers to properties that are acquired with the intention to develop or construct homes, including all forms of development for single-family housing, such as condominiums, town homes, zero lot line developments, planned unit developments with and without common areas, and standard subdivisions.

Incidental Development - Incidental commercial/multi-family infrastructure lot development may be undertaken in the Program, provided that it is not a major cost of the overall single-family project.

Land Development - Land development refers to properties that are acquired with the intention to develop or construct infrastructure, including all forms of acquisition and infrastructure development for single-family housing, such as condominiums, town homes, zero lot line developments, planned unit developments with and without common area, and standard subdivisions.

Land Entitlement Risk - Land entitlement risk reflects the risks assumed by an investor when purchasing a parcel of land prior to the tentative map and other discretionary political approvals being granted by the appropriate regulatory bodies.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
SPECIALIZED (OR "NON CORE") EQUITY REAL ESTATE

August 18, 2003

This Policy is effective immediately upon adoption and supersedes all previous specialized real estate investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Specialized (or "Non Core") Equity Real Estate Portfolio ("the Portfolio"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the real estate portfolio.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return possible, consistent with a prudent level of risk, the liabilities of the System, and the investment guidelines contained herein, is the strategic objective of the Portfolio. The System's Non Core Portfolio is generally expected to produce higher returns than the Core Real Estate Portfolio or to fulfill specific targeted investments with acceptable returns. Furthermore, the Portfolio is expected to increase the overall performance of the Equity Real Estate Portfolio, subject to an incrementally greater amount of risk. Additionally, specialized portfolio investments should diversify the systematic risk (or other characteristics or both) of the Core Portfolio.

The Non Core Portfolio consists generally of investments with expected returns in excess of the Core Portfolio and above market risk. These investments are often found in niche opportunities (e.g., timber or hotels) or exist because of inefficiencies in the real estate or capital markets. Additionally, the Non Core Portfolio may contain investments in special purpose properties with a narrow user market (e.g., mobile home parks).

Investment strategies for the Portfolio shall be characteristically "opportunistic," based on prevailing market conditions at the time of investment. Specific policies shall be developed as necessary, to take advantage of specialized real estate investment opportunities as they arise. Some examples of specialized real estate investment programs include, but are not limited to, investment strategies focused on the following:

A. Developmental properties;

B. Timber land;

C. Agricultural land;

D. Urban real estate initiatives;

E. Hotels and motels;

F. Franchise finance net leased properties;

G. International real estate.

H. Senior Housing;

I. Real estate technology;

J. Real estate private equity;

K. Opportunistic Investments; and

L. Single family housing program.

(See Appendix I for a list of Portfolio Policies.)

Investments shall be subject to the Statement of Investment Objectives and Policies for the Equity Real Estate Investment and the Delegation and Approval Guidelines, which are incorporated by, referenced hereto. The Portfolio Policy is an elaboration of Section VIII.D, "Specialized Portfolio," of the Statement of Investment Objectives and Policies for the Equity Real Estate Investment.

III. PERFORMANCE OBJECTIVES

The Non Core Portfolio shall be expected to achieve a minimum, long-term, real rate-of-return that is consistent with the overall objectives of the Equity Real Estate Portfolio and may be reflective of higher levels of risk, often characteristic of its constituent investments, as appropriate.

Investment selection should be oriented to the preservation of capital and achievement of real rates of return.

The performance of the specialized investments shall be compared to U.S. equity real estate benchmarks (the NCREIF or WRESI indices) and target returns in excess of the minimum 5% overall real-return objective for the U.S. Core Equity Real Estate Portfolio. When appropriate, customized benchmarks shall also be developed for these investments, taking into account specific risk attributes of the investments, (e.g., the international and timber sectors).

Within the Portfolio, expected returns may vary considerably, but shall be set individually for each investment program at the time of approval. Investments included in the Portfolio are also likely to generate limited current income. The bulk of the return on these investments is expected to come from appreciation. Some programs may employ moderate-to-high levels of leverage to augment performance.

IV. INVESTMENT APPROACH AND PARAMETERS

A. Risks

There are specific risks associated with investments that shall be carefully monitored and mitigated by the System. Mitigating factors and techniques are somewhat dependent upon the individual investment program. Those risks shall be described within each investment program policy as follows:

1. **Financial -** Portfolio investments often employ a greater use of financial leverage that can lead to greater volatility in returns.

2. **Operating and Business -** Certain investments entail above average operating and business risk (e.g., hotel, senior housing).

3. **Liquidity -** Many investments carry an additional liquidity risk beyond the normal private market real estate investment liquidity risk (e.g., owning units of a commingled fund). Additionally, liquidation proceeds may compose the bulk of the return on investments.

4. **Structural -** The System negotiates and structures specific fundamental rights and protections, which include mechanisms to take remedial action. These basic protections include advisory committee participation and

specific termination provisions in partnership transactions and anti-dilution, put-and-call options, voting rights for material events, and other covenants and governance provisions for direct investments.

5. **Valuation -** Partnerships shall be evaluated by the System to determine if the general partner employs an appropriate valuation discipline.

6. **Country -** Political, economic, and currency risks associated with investing outside of the United States shall be evaluated by the System.

B. **Diversification Guidelines**

Capital allocations shall be primarily driven by market opportunities. The System shall seek to maintain a prudent level of diversification within and among such investments. Care shall be given to avoid undue concentrations in any one particular investment strategy.

C. **Investment Size**

The size of Portfolio investments shall depend on the opportunities available to the System, with neither small nor large investments dominating the Portfolio. Furthermore, investment size shall be appropriate to the projected risk versus return level of the investments. However, in order to have some affect on the composite Equity Real Estate Portfolio, preference shall be given to investments with funding commitments of $50 million (or greater) in size.

D. **Structures**

The Portfolio shall be implemented primarily through direct equity investments in real estate (either 100% owned or through joint ventures or other co-investment vehicles). Equity (privately-held or publicly-traded), leveraged equity, and debt instruments with equity-like features, are also appropriate structures for investments.

E. **Vehicles**

1. The System shall consider a number of different vehicles for investments including, but not limited to, the following:

   a. Equity investments in 100% owned assets;

b. Equity joint ventures or other co-investment vehicles;

c. Indirect equity investments in commingled funds; private or public REITS and corporations; limited partnerships; or other pooled investment vehicles;

d. Private placements of equity or debt in public or private real estate operating companies; and

e. Lower or unrated tranches of pre-existing securitized or structured debt instruments, such as mezzanine or other debt with equity-like features.

2. In choosing specific investment vehicles for Portfolio investments, consideration shall be given, but not limited, to the following:

   a. Proposed investment strategy

   b. Expected risk and return attributes of vehicles

   c. Potential diversification benefits

   d. Investment time horizon

   e. Potential exit strategies and liquidity

   f. Monitoring costs and feasibility

   g. Tax considerations

   h. Other incremental costs

   i. Fee arrangements

   j. Co-investment by management

   k. Potential conflicts of interest

   l. Governance and control

   m. Partners or co-investors

F. **Selection of Investment Managers**

The System shall make investments through third-party investment advisors, general partners, operating company management teams or other organizations with specific expertise in investments (collectively referred to as "Management Firms"). Management Firms shall provide expertise and experience in locating, negotiating, monitoring, and disposing of investments. The System shall establish and document specific relevant criteria for each Management Firm before they are selected to establish the basis on which the selection shall be made. Selection of management is critical to the success of the Portfolio. The System shall approve Management Firms based on their reputation and successful history or significant potential in managing and implementing investment programs.

Management Firms and advisors for investments shall be selected by the System pursuant to the Delegation and Approval Guidelines. The Staff may recommend the use of management firms or multiple advisors for a specific investment program. Upon selection, the Staff and the advisor(s) selected shall refine and implement the investment program for the strategy, as outlined in policy documents. Management Firms shall prepare Annual Investment Plans, manage System assets, implement approved Annual Investment Plans, and provide quarterly reports in accordance with System standards.

If the use of commingled funds is selected, the Staff shall perform analysis of appropriate available commingled funds with the assistance of the consultant, as appropriate. The Staff shall make recommendations concerning their analysis of commingled funds to the Investment Committee. Investments in commingled funds may involve the use of investment advisors not previously approved by the Investment Committee.

G. **Asset Management**

Management Firms shall represent the System's interests in asset management decisions and oversee or provide daily property management services, as expertise and organizational structure allows, and act in a fiduciary capacity. The System shall give Management Firms the appropriate delegation of authority. Management Firms shall provide suitable measures of accountability to the System.

The System shall require that each specialized investment have investment program parameters and contractual relationships with the Management Firms selected.

The Real Estate Equity Unit and the consultant (as appropriate) shall develop investment program parameters. The parameters developed shall be subject to approval by the Investment Committee. Important program parameters include the following:

1. **Program Size** - Funds allocated to the market segment;

2. **Timing** - Target date for investment of allocated funds;

3. **Diversification** - Target allocation of funds among geographic regions and sub markets within the market segment as appropriate;

4. **Investment Guidelines** - Specification of the investment guidelines for acceptable investments within the market segment; and

5. **Asset Management** - Specification of the expected value-enhancing activities that shall result in maximizing returns to the System.

The Real Estate Equity Unit and the System's legal counsel shall have the joint responsibility for developing the contractual relationship. Generally, the contract standards shall adhere to the form established by the System's other equity real estate advisory contracts.

Unless specifically delegated in the contract, the Delegation and Approval Guidelines shall govern the decision-making in Portfolio investments.

V. GENERAL

A. This Policy contains a Glossary of Terms in Section VII. of this document.

B. The Portfolio shall be subdivided, based on investment strategy or program (e.g., timber or franchise finance). Unless otherwise delegated, Portfolio investment programs shall be approved by the System's Investment Committee ("the Investment Committee") before being implemented. Portfolio investment programs are also to be administered, subject to the adoption of specific investment policy or guidelines for each program. A list of policies for existing Portfolio investment programs are included in Appendix I of this Policy.

All calculations and computations shall be on a fair market value basis, unless otherwise noted. When reporting fair market value for accounting purposes, market value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation, shall be incorporated. The standards of the individual, specialized industries shall be followed where there are differences between USPAP and specialized sector practices (e.g., timber or agricultural land).

VI. ASSET ALLOCATION

The Portfolio shall comprise 20-50% of the target allocation to the Equity Real Estate Portfolio. The remaining 50-80% of the target allocation to the Equity Real Estate Portfolio is assigned to the Core Portfolio. From time-to-time, there may be differences between the target and actual allocation to the Equity Real Estate Portfolio. Thus, the Portfolio shall be limited to no more than 50% of the actual allocation to the Equity Real Estate Portfolio. The allocation ranges for the Core and Non Core Portfolios shall also be adjusted, on occasion, for risk-management purposes.

No individual non-core program will exceed 15% of the total real estate equity allocation. Current asset allocation ranges for the individual Specialized programs, as a percent of the total real estate equity allocation are as follows:

Program	Range
Timber Land and Agricultural Land	0-15%
Single-Family Housing Program	0-15%
California Urban Real Estate	0-15%
Alternative Strategies[1]	0-15%
Senior Housing	0-15%
International	0-15%
Specialized Securities (Extended Market PREES)	0-15%

From time-to-time, the actual investment may fall out of the ranges prescribed by Policy. In these instances, adjustments to correct the actual allocation ranges to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

[1] Alternative Strategies include opportunistic investment programs such as domestic and international opportunities, hotel investments and mezzanine debt investments.

As investments in the Portfolio mature, their characteristics may migrate towards a more core-like profile. The Real Estate Consultant or Staff or both shall monitor the Equity Real Estate Portfolio for instances when changes in the classification of investments from the Non Core Portfolio to the Core Portfolio are warranted. The Consultant or the Real Estate Equity unit or both shall make recommendations to the Investment Committee for approval of such reclassifications.

VII. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

National Council of Real Estate Investment Fiduciaries Index ("NCREIF Index") – A property level performance benchmark for institutionally owned real estate. The benchmark is composed of an Income Return, an Appreciation Return and a Total Return and is calculated on a quarterly basis.

NCREIF – National Council of Real Estate Investment Fiduciaries.

USPAP – Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation may be referenced for a standard definition of "market value" or "fair market value" for accounting purposes.

WRESI - Wilshire Real Estate Securities Index.

Appendix I

Policy List for Specialized ("Non Core") Real Estate Equity Portfolio Investment Programs

A. Statement of Investment Policy for Franchise Finance Real Estate;

B. Statement of Investment Policy for International Real Estate;

C. Statement of Investment Policy for Agricultural Land Real Estate;

D. Statement of Investment Policy for California Urban Real Estate;

E. Statement of Investment Policy for Timber Real Estate;

F. Statement of Investment Policy for Single Family Housing Program;

G. Statement of Investment Policy for Extended Market Public Real Estate Equity Securities (Extended Market PREES); and

H. Statement of Investment Policy for Senior Housing.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
TIMBER REAL ESTATE

December 17, 2001

This Policy is effective immediately upon adoption and supersedes all previous timber real estate investment policies.

I. PURPOSE

This document sets forth the investment policy (“the Policy") for the Timber Investment Real Estate Portfolio (“the Portfolio”). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System (“the System") take prudent and careful action while managing the Portfolio. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of real estate.

II. STRATEGIC OBJECTIVE

Achieving the highest total rate of return possible, consistent with a prudent level of risk, the liabilities of the System, and the investment guidelines contained herein is the strategic objective of this Portfolio. The System's timber investments shall be considered a component of the specialized equity real estate portfolio. As such, the Portfolio shall achieve an appropriate risk adjusted return.

The Portfolio shall be managed to accomplish the following:

A. Preserve investment capital;

B. Generate attractive risk-adjusted rates of return for the System as a total return investor, including the following components:

1. Provide, at a minimum, moderate to low cash flow from operations; and

2. Provide appreciation potential as a result of biological growth and employing active management techniques including, but not limited to, silvicultural best practices.

C. Provide a hedge against inflation; and

D. Consider solely the interest of the System's participants and beneficiaries in accordance with California State Law.

III. PERFORMANCE OBJECTIVES

Managing the Portfolio shall assist the System in achieving the following overall long-term objectives:

A. Exceeding a minimum target real rate of return of 6.0% (after fees).

B. Exceeding, on a before-fee basis, the National Council of Real Estate Investment Fiduciaries Timber Index ("NCREIF Timber Index") while maintaining an appropriate level of risk.

IV. INVESTMENT APPROACHES AND PARAMETERS

A. Environmental Considerations

Maximizing the economic benefits to the System is the primary objective of the timber investment program. The management of each investment shall incorporate sound environmental principles with full consideration of impacts on wildlife, water and air quality, recreation, and soil conservation. Respecting the desire to maintain environmental quality, the System shall strive to use the best and highest forest management standards commercially and economically feasible while meeting or exceeding the performance objective.

B. Investment Objectives and Criteria

1. Investment Quality

a. Timberland tracts shall be comparable in quality to those held by other institutional investors or the forest products industry to enhance an exit strategy.

b. Tracts shall be located within strong market areas defined as having multiple wood using facilities of various types (e.g., sawmills, pulp mills, and collection yards), preferably within 75 miles.

c. Equity ownership of timber real estate shall be acquired, which includes underlying land, water, and mineral rights if available and economically feasible.

2. Diversification

The Portfolio shall be appropriately diversified to reduce risk. Furthermore, the Portfolio shall be managed to maintain a degree of diversification with regard to geography and timber species, both age and product type.

a. Diversification by Geography

Allocation ranges have been established for each of the recommended geographic regions, as well as a domestic and international component. Market opportunities and conditions, rather than absolute and precise diversification targets, shall be the overriding factors in assembling the timberland portfolio.

Region	Allocation Range
Domestic	90-100%
South	40- 70%
Northwest	20- 50%
Northeast	0- 5%
International	0- 10%

The System may consider investing in international timber with full analysis of tax consequences among other factors. See Statement of Objectives and Policy for International Equity Real Estate (Section IV.A.1.). General U.S. environmental principles and land management best practices shall be considered prior to any international timber investment and in the property management and operation of an investment.

b. Diversification by Species, Age, and Product Type

The Portfolio shall be diversified so no one specie or product (pulpwood, sawtimber, or specialty hardwood) shall dominate the Portfolio.

The Portfolio shall be managed to maintain a degree of diversification in order to minimize market risk; that is, price dependence within a certain harvest period.

3. Investment Asset Size

Individual tract investments shall have a preferred size range of $2-50 million in order to enhance liquidity of the Portfolio. A tract shall be one or more parcels of timberland with unity of title, use, and contiguity. Non-contiguous parcels of land may be considered a tract if there is unity in operation.

4. Investment Holding Period/Dispositions

   The target holding period for timberland assets shall generally be for long-term investment (10 years or more). However, disposition of individual tracts may be triggered by an opportunity to capture a return in excess of the targeted return, or by a revised investment strategy resulting from changes in timber markets or changes in the System's financial objectives.

5. Leverage

   Subject to qualifications stated in the Equity Real Estate Leverage Policy, the Timber Real Estate Investment Portfolio shall be permitted to leverage the portfolio up to a maximum of 40%, subject to approval by the SIO Real Estate or the Chief Investment Officer.

6. Property Management

   a. The investment manager shall be responsible for developing operating management plans, strategic plans and budgets, and on-site supervision of each timberland holding. Tracts must be physically inspected at least once a year. Emphasis shall be placed on active management to capitalize on opportunities that add value.

   b. On-site property management shall be conducted, under the supervision of the investment manager, by firms with an established presence in the local timberland markets and demonstrated expertise in optimizing timber property performance.

   c. Each holding shall be managed to maximize its timber producing capabilities.

      (1) Open areas shall be planted as soon as possible.

      (2) Roads and boundary lines shall be inspected and maintained regularly.

      (3) Hunting rights and other sources of lease income shall be obtained where possible.

   d. Management shall comply with all appropriate federal, state, and local regulations.

   e. Where prudent and economically practical, recreational use of properties shall be permitted, with consideration for minimizing legal liability risks.

f. The generation of cash flow shall be secondary to producing long-term total returns.

7. Prohibited Investments

The purchase of land for the primary purpose of commercial land development and speculation shall be prohibited.

V. GENERAL

This Policy contains a Glossary of Terms in Section VIII. of this document.

VI. VALUATION

All calculations and computations shall be on a fair market value basis unless otherwise noted. Market value, as defined by the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation, shall be incorporated when reporting fair market value for accounting purposes. The standards of the timber industry in appraising timberland shall be followed where there are differences between USPAP and timber industry practices.

VII. ASSET ALLOCATION

The following is the current asset allocation range for the Timber Portfolio, as a percent of the total allocated Real Estate Portfolio:

	Range
Timber Portfolio:	10-20%

As a percent of the total allocated Specialized Portfolio, timber shall range from 20-45%.

From time to time, the actual allocation may fall out of the ranges prescribed by the Policy. In these instances, adjustments to correct the actual in order for it to comply with the Policy allocation ranges shall be implemented on an opportunistic basis over a reasonable time frame (normally within a three-year period), and with ample consideration given to preserving the investment returns of the System.

VIII. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System’s Master Glossary of Terms.

NCREIF Timber Index - National Council of Real Estate Investment Fiduciaries Timber Index.

Silvicultural – Care and cultivation of forest trees.

Appendix I

Distribution of States for Timber Geographic Allocation

Northwest Region	South Region	Northeast Region	Midwest Region
Alaska *Arizona* *California* *Colorado* *Hawaii* *Idaho* *Montana* *Nevada* *New Mexico* *Oregon* *Utah* *Washington* *Wyoming*	*Alabama* *Arkansas* *Delaware* *Florida* *Georgia* *Kentucky* *Louisiana* *Mississippi* *Tennessee* *Missouri* *North Carolina* *Oklahoma* *South Carolina* *Texas* *Virginia* *West Virginia*	*Connecticut* *Maine* *Maryland* *Massachusetts* *New Hampshire* *New Jersey* *New York* *Pennsylvania* *Rhode Island* *Vermont*	*Illinois* *Indiana* *Iowa* *Kansas* *Michigan* *Minnesota* *Nebraska* *North Dakota* *Ohio* *South Dakota* *Wisconsin*